BEFORE THE ARIZONA CORPORATION CC

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COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744	DOCKET NO. E-01345A-06-0009 **STAFF'S NOTICE OF FILING TESTIMONY**

The Arizona Corporation Commission Utilities Division ("Staff") hereby provides notice of filing of the Testimonies of Ralph C. Smith, J. Randall Woolridge, Barbara Keene, and William Gehlen. A confidential version of Barbara Keene's testimony has also been provided under seal to the Commissioners, their aides, the assigned administrative law judge, and Arizona Public Service Company.

RESPECTFULLY SUBMITTED this 28th day of February, 2006.

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DOCKET NOS. E-01345A-06-0009

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744

FEBRUARY 28, 2006

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744.	DOCKET NO. E-01345A-06-0009

DIRECT

TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF

THE ARIZONA CORPORATION COMMISSION,

UTILITIES DIVISION STAFF

FEBRUARY 28, 2006

TABLE OF CONTENTS

Page

ATTACHMENTS:

Attach-ment No.	Description	Number of Pages	APS Marked "Confidential"
RCS-1	Resume and Qualifications	8	No
RCS-2	STF 1-11, APS projection of native load fuel and purchased power costs for 2006	1	No
RCS-3	Standard & Poors report dated January 26, 2006, affirmed the corporate credit rating of APS and its parent, Pinnacle West Capital Corp.	2	No
RCS-4	Fitch Ratings January 30, 2006 report, which lowered PNW's long- and short-term ratings, and lowered APS's long-term ratings, while affirming its commercial paper rating.	2	No
RCS-5	Standard & Poors discussion of its outlook and expectations for APS's emergency interim filing in a report issued January 24, 2006	3	No
RCS-6	APS's response to STF 4-48, *financial results assuming present rates, PSA deferrals, but no PSA increase*	1	No
RCS-7	APS's response to STF 1-6 identifies approximately $1 million of increased cost associated with S&P's rating downgrade to BBB-	1	No
RCS-8	APS's response to STF 1-14 explained why APS believed it was experiencing an "emergency."	3	No
RCS-9	APS's response to STF 4.7 listing provisions in APS's indentures that address minimum financial ratios and default conditions.	1	No
RCS-10	APS's response to STF 4.8 listing provisions in APS's indentures and credit arrangements that address minimum financial ratios and default conditions.	1	No
	TOTAL	23	

I. INTRODUCTION

Q. Please state your name, position and business address.

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

Q. Please describe Larkin & Associates.

A. Larkin & Associates is a Certified Public Accounting and Regulatory Consulting firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous telephone, water and sewer, gas, and electric matters.

Q. Mr. Smith, please summarize your educational background.

A. I received a Bachelor of Science degree in Business Administration (Accounting Major) with distinction from the University of Michigan - Dearborn, in April 1979. I passed all parts of the C.P.A. examination in my first sitting in 1979, received my CPA license in 1981, and received a certified financial planning certificate in 1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law degree (J.D.) cum laude from Wayne State University, 1986. In addition, I have attended a variety of continuing education courses in conjunction with maintaining my accountancy license. I am a licensed Certified Public Accountant and attorney in the State of Michigan. I am also a Certified Financial Planner™ professional and a Certified Rate of Return Analyst (CRRA). Since 1981, I have been a member of the Michigan Association of Certified Public Accountants. I am also a member of the Michigan Bar Association and the Society of Utility and Regulatory Financial Analysts (SURFA). I have also been a member of the

American Bar Association ("ABA"), and the ABA sections on Public Utility Law and Taxation.

Q. Please summarize your professional experience.

A. Subsequent to graduation from the University of Michigan, and after a short period of installing a computerized accounting system for a Southfield, Michigan realty management firm, I accepted a position as an auditor with the predecessor CPA firm to Larkin & Associates in July 1979. Before becoming involved in utility regulation where the majority of my time for the past 26 years has been spent, I performed audit, accounting, and tax work for a wide variety of businesses that were clients of the firm.

During my service in the regulatory section of our firm, I have been involved in rate cases and other regulatory matters concerning numerous electric, gas, telephone, water, and sewer utility companies. My present work consists primarily of analyzing rate case and regulatory filings of public utility companies before various regulatory commissions, and, where appropriate, preparing testimony and schedules relating to the issues for presentation before these regulatory agencies.

I have performed work in the field of utility regulation on behalf of industry, state attorney generals, consumer groups, municipalities, and public service commission staffs concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Washington, Washington D.C., and Canada as well as the Federal Energy Regulatory Commission and various state and federal courts of law.

Q. Have you prepared an attachment summarizing your educational background and regulatory experience?

A. Yes. Attachment RCS-1 provides details concerning my experience and qualifications.

Q. Have you previously submitted testimony and/or testified before other state regulatory commissions on issues involving the review of electric utility fuel and purchased power?

A. Yes. I have submitted testimony and/or testified in several proceedings involving the review of electric utility fuel and purchased power issues. Recent examples include the following:

Docket No.	Utility	Description	Client
05-806-EL-UNC	Cincinnati Gas & Electric Company	Financial and Management/Performance Audit of the Fuel and Purchased Power Rider	Energy Ventures Analysis, Inc./ Public Utility Commission of Ohio
21229-U	Savannah Electric & Power Company	FCR Fuel Case	Georgia Public Service Commission Staff
A.96-10-038	Pacific Enterprises and Enova Corporation d/b/a as Sempra Energy	Management Audit and Market Power Mitigation Analysis of the Merged Gas System of Pacific Enterprises and Enova Corporation	California Public Utilities Commission - Energy Division
19142-U	Georgia Power Company	FCR Fuel Case	Georgia Public Service Commission Staff
19042-U	Savannah Electric & Power Company	FCR Fuel Case	Georgia Public Service Commission Staff
ER 02060363	Rockland Electric Company	Audit of Deferred Balances, Phase I and II	New Jersey Board of Public

			Utilities
Non-Docketed	Georgia Power Company & Savannah Electric & Power Company	Fuel Procurement Review	Georgia Public Service Commission Staff
13711-U	Georgia Power Company	FCR Fuel Case	Georgia Public Service Commission Staff
13605-U	Savannah Electric & Power Company	FCR Fuel Case	Georgia Public Service Commission Staff
13196-U	Savannah Electric & Power Company	Natural Gas Procurement and Risk Management Hedging Proposal	Georgia Public Service Commission Staff
U-12604	Upper Peninsula Power Company	Power Supply Cost Recovery Plan	Michigan Attorney General
U-12613	Wisconsin Public Service Corporation	Power Supply Cost Recovery Plan	Michigan Attorney General

Q. On whose behalf are you appearing?

A. I am appearing on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. Have you previously testified before the Arizona Corporation Commission?

A. Yes. I have testified before the Commission previously on a number of occasions.

Q. What is the purpose of the testimony you are presenting?

A. The purpose of my testimony is to address the application for an emergency interim rate increase filed by Arizona Public Service Company ("APS" or "Company") for accelerated recovery of $299 million of estimated under-recovered fuel and purchased power costs.

Q. Have you prepared any exhibits to be filed with your testimony?

A. Yes. Attachments RCS-2 through RCS-10 contain copies of selected APS responses to discovery and other documents that are referenced in my testimony.

Q. Please briefly describe the information you reviewed in preparation for your testimony.

A. The information I reviewed included APS's application and testimony, APS's responses to data requests of Staff and other parties, information provided to me by Staff, and other publicly available information.

Q. Please provide some background for the request that APS has made in the current proceeding.

A. APS is an Arizona utility providing electricity to more than 1 million customers in 11 of Arizona's 15 counties. With its headquarters in Phoenix, APS is the largest subsidiary of Pinnacle West Capital Corporation ("PWC" or "PNW"[1]).

APS' current rates became effective April 1, 2005, pursuant to Decision No. 67744, dated April 2, 2005, which adopted a Settlement Agreement among Staff, the Company and numerous intervenors. The Agreement resulted in a total revenue requirement increase of $75.5 million or approximately 4.3 percent over test year revenues. The approved Settlement Agreement also implemented a Power Supply Adjustor ("PSA") which provides for the recovery of both fuel and purchased power costs through an adjustor and possible surcharge.

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[1] PNW is the stock symbol for Pinnacle West Capital and rating agency and investment reports therefore use "PNW." In this testimony, both abbreviations, PWC and PNW, are used interchangeably.

On July 22, 2005, APS filed with the Commission an application for approval to institute a surcharge to recover $100 million in deferred fuel and purchased power costs. The request was subsequently reduced to $80 million. Hearings were held on the matter in October 2005. An Administrative Law Judge issued a Recommended Opinion and Order ("ROO") on January 4, 2006, which found the application for surcharge to be premature and, therefore, denied. The Commission's January 25, 2006, Decision No. 68437 reached the same conclusion, and ruled that APS's application for that surcharge was premature and therefore denied. However, that decision also accelerated the reset of the adjustor rate from April 1, 2006, to February 1, 2006.

On November 4, 2005, the Company filed a general rate application[2] with the Commission and proposes that the new rates become effective no later than December 31, 2006. The request was for a revenue increase of $409 million, a 20.0 percent increase over the revenues of the 2004 calendar year Test Year. The Company indicated that approximately $246 million of the proposed revenue increase was attributable to higher fuel and purchased power costs. On December 5, 2005, Staff filed a letter in the docket documenting an understanding between Staff and APS that APS would update financial schedules, testimony and other data in the November 4th filing and will complete the revisions by January 31, 2006.

On January 31, 2006, APS filed its update, using a test year ended September 30, 2005. As a result of the updated filing, APS is requesting a 21.3%, or $453.9 million, increase in its annual retail electricity revenues effective no later than December 31, 2006. The $453.9 million increase that APS has requested includes $299 million for increased fuel and purchased power cost.

[2] Docket No. E-01345A-05-0816.

On January 6, 2006, in the instant proceeding, Docket No. E-01345A-06-0009, APS filed the application at issue which is an application for an emergency rate increase of $299 million, or $14%, to be effective April 1, 2006 and subject to refund. As noted above, the $299 million is the amount of increased fuel and purchased power cost contained in the Company's January 31, 2006 updated rate case filing, Docket No. E-01345A-05-0816. The Company's Securities and Exchange Commission ("SEC") Form 8-K dated January 6, 2006 stated that:

> "**<u>The purpose of the emergency interim rate increase is solely to address APS' under-collection of higher annual fuel and purchased power costs</u>**. The increase would **<u>accelerate</u>** recovery of the fuel and purchased power component of APS' general rate case and is not an additional increase and would be subject to refund."

(Emphasis supplied.)

On January 25, 2006, the Commission issued Decision No. 68437 in Docket No. E-01345A-03-0437 et al, which I have already referred to on page 6. In that decision, the Commission approved a 4 mill increase in APS's PSA rate effective February 1, 2006 and has allowed APS to defer fuel and purchased power costs in excess of the $776.2 million annual power supply cost limit referenced in Decision No. 67744 until this issue has been further examined in the current docket.

On February 2, 2006, APS filed an application for two PSA surcharges totaling $59 million.[3]

II. DISCUSSION OF ISSUES

Q. What issues are addressed in your testimony?

A. My testimony addresses the following issues:

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[3] Docket No. E-01345-06-0063.

- The $776.2 million cap on APS' recovery of fuel and purchased power expenses
- Whether APS is experiencing a financial "emergency"
- Whether the emergency rate relief requested by APS should be granted
- Whether any requirements should be placed on the Company as conditions for approval of all or part of its Emergency request.
- Whether it would be appropriate for APS to post a bond if the relief they are requesting is approved.
- The operation of the PSA as it relates to APS's request for an emergency rate increase

A. The $776.2 Million Cap

Q. Please discuss the $776.2 million cap and how it originated.

A. The $776.2 million cap originated in APS's last base rate case, Docket No. E-01345A-03-0437. The Settlement Agreement in that case provided that a Power Supply Adjustor ("PSA") be implemented and remain in effect for a minimum of five years, with reviews available during APS's next rate case or upon APS's filing its report on the PSA four years after rates are implemented in that case. The $776.2 million cap was not incorporated into the Settlement Agreement, but was added by the Commission to "help to lessen the detrimental impact to ratepayers of this change to an adjustor mechanism." In this regard, Decision No. 67744 (4/7/2005), at pages 17-18, states as follows:

> "Further, we will limit the amount of 'annual net fuel and purchased power costs' ... that can be used to calculate the annual PSA to no more than $776,200,000. Any fuel or purchased power costs above that level will not be recovered from ratepayers. We believe that this 'cap' on fuel and purchased power costs will further encourage APS to manage its costs, and will help to prevent large account balances from occurring in one year. Because the PSA actually adjusts for growth, putting a 'cap' on recovery of these costs will help insure that APS will file a rate case application when necessary. Since there is no moratorium on filing a rate case, APS can file a rate case to reset base rates if it deems it necessary because the cap is reached. Further, although the Settlement Agreement provides that the PSA will be in effect for 5 years, if APS files a rate case prior to the expiration of that 5 year term or if we find that APS has not complied with the terms of the PSA, we believe that the Commission should be able to eliminate the PSA if appropriate. Finally, we will not allow any fuel costs from 2005 that were incurred prior to the effective date of this Decision to be included in the calculation of the PSA

> implemented in 2006. We believe that these additional provisions to the PSA will help to lessen the detrimental impact to ratepayers of this change to any adjustor mechanism."

The operation of the cap subsequently received considerable attention from the Commission in Docket No. E-03145A-03-0437 et al where the Commission considered a Revised Plan of Administration that was filed pursuant to the Commission's Decision No. 67744.

Q. Did the $776.2 million cap affect APS's operations in 2005?

A. No. The $776.2 million cap did not affect APS's operations in 2005. In 2005, APS's fuel and purchased power costs were below the cap.

Q. Does the Company project that its fuel and purchased power expenses will exceed $776.2 million in 2006?

A. Yes. APS's projections, which were provided in the response to STF 1-11, indicate that the Company anticipates incurring $901.5 million in fuel and purchase power costs in 2006, before off-system margin.[4] Consequently, APS has projected that it will exceed the $776.2 million cap by the end of 2006.

Q. Does one of the Commission's recent orders impact how the $776.2 million cap will affect APS's operations in 2006?

A. Yes. The Commission's recent Decision No. 68437 (1/26/06) in Docket No. E-01345A-03-0437 et al, at page 26, ordered that APS:

> "may continue to defer fuel and purchased power costs in excess of the $776.2 million 'cap' referenced in Decision No. 67744 until this issue has been further examined in Docket No. E-01345A-06-0009."

[4] See Attachment RCS-2, which reproduces the non-confidential portion of APS's response to STF 1-11.

Q. How will the $776.2 million cap affect APS's operations in 2006?

A. The answer to this would appear to be dependent upon whether or not the cap is reinstated after further examination in the current docket. As long as APS is allowed to continue to defer fuel and purchased power costs above that "cap," there should be no impact on APS's operations in 2006.

Q. Was the "cap" intended to deny APS recovery of prudently incurred fuel and purchased power costs?

A. My understanding from reading various materials, including Decision No. 68437, is that the $776.2 million "cap" was not intended to deny APS recovery of prudently incurred fuel and purchased power costs.

Q. Did having the $776.2 million cap in place during 2005 achieve some of the desired objectives?

A. Yes, it did. One objective of instituting the cap was identified by the Commission in Decision No. 67744, at page 17, specifically: "putting a 'cap' on recovery of these costs will help insure that APS will file a rate case application when necessary." That page of the Decision also states: "APS can file a rate case to reset base rates if it deems it necessary because that cap is reached." APS forecasts that the cap will be exceeded in 2006 and has filed a rate case application, so that objective of having the cap has been fulfilled.

A second impact of the cap identified by the Commission at page 17 of that Decision was that having "this 'cap' on fuel and purchased power costs will further encourage APS to manage its costs." APS has taken at least some proactive steps to manage its exposure to upside price volatility in natural gas and purchased power costs, including implementing what appears to be a fairly aggressive hedging program.[5]

Q. Does the $776.2 million cap currently constitute a "financial emergency" for APS?

A. No, for two reasons: (1) APS has not yet incurred fuel and purchased power costs in excess of the cap, and (2) the Commission's January 25, 2006 Decision No. 68437 has allowed APS to defer fuel and purchased power costs in excess of the cap. Because APS has been allowed to defer fuel and purchased power costs in excess of the cap, as provided in that Decision, the $776.2 million cap does not constitute a "financial emergency" for APS.

Q. What have the credit rating agencies stated about the $776.2 million cap and the Commission's January 25, 2006 Decision No. 68437?

A. Standard & Poor's published a report dated January 26, 2006, that affirmed the corporate credit rating of APS and its parent, PWC. That report is provided for ease of reference in Attachment RCS-3 to my testimony. In that report, S&P stated that these ratings were affirmed and the outlook was stable:

> "...following the generally constructive decisions made by the Arizona Corporation Commission (ACC) on Jan. 25. The commission lifted a cap that limited APS' opportunity to recover fuel and purchase power costs and modestly advanced the collection of deferred costs that APS was incurring under the terms of its power supply adjuster (PSA). However, the ACC also restricted APS' ability to file for a surcharge, which raises certain credit concerns. The outlook is stable.
>
> "The ACC vote to remove the $776 million cap on annual fuel and purchase power costs is favorable because it allows APS to defer any costs

[5] See, e.g., Docket No. E-01345A-05-0816, Direct Testimony of Peter Ewen (1/31/06), page 5: "By the end of August 2005, the Company had hedged 85% of its 2006 gas and power requirements. The vast majority of these contracts are at prices significantly below recent market prices and, valued at November 30, 2005, will save the Company and its customers almost $2.50/MMBtu on the effective gas price incurred in 2006."

> that exceed this level, which is in fact expected to occur in late 2006. APS' current deferral level is about $170 million, which will likely increase by approximately $250 million this year. The ACC adopted an amendment to advance the commencement of recovery of these costs by two months to Feb. 1 from April 1. While the impact is small, providing APS only about $14 million of incremental recovery in 2006, the vote is an important indicator that the ACC acknowledges that timely action is necessary to limit cash flow pressure on the company."

Fitch Ratings, in a January 30, 2006 report, lowered PWC's long- and short-term ratings, and lowered APS's long-term ratings, while affirming its commercial paper rating.[6] Fitch removed the securities of PWC and APS from Rating Watch Negative, where they were placed January 6, 2006. Fitch indicates that its Rating Outlook for these is Stable. Concerning the Commission's January 25, 2006 Decision, the Fitch report stated that:

> "The ACC decision in the PSA proceedings, issued on Jan 25, 2006, has positive and negative implications for PNW and APS' creditworthiness. The commission's decision to accelerate the effective date of the PSA rate to Feb. 1 from April 1, along with the removal of the $776 million annual power supply cost limit, were constructive developments in Fitch's view."

Notably, the outlook for APS and its parent company, PNW, in both the S&P and Fitch credit agency reports is listed as "stable."

Q. What was APS's concern regarding the $776.2 million cap?

A. APS's primary concern regarding the cap was that, without an interim lifting of the cap, APS would be unable to defer some $65 million in estimated 2006 fuel costs, thus potentially affecting its ability to ever recover such sums. Page 18 of APS's application claims that:

[6] See Attachment RCS-4 for a copy of the Fitch report.

> "The lack of any reasonable prospect for resolution of Docket No. E-01345A-05-0816 prior to the Company reaching the $776.2 million 'cap' means the potential for tens of millions of prudently-incurred costs becoming unrecoverable by any means during the fourth quarter of this year."

Q. Did the Commission's January 25, 2006 Decision address and alleviate that concern?

A. Yes. The Commission's January 25, 2006 Decision No. 68437 to permit APS to defer fuel and purchased power costs in excess of $776.2 million has effectively remedied this concern.

Q. What do you recommend concerning the $776.2 million cap?

A. APS should be allowed to defer fuel and purchased power costs in excess of the cap in 2006. The actual costs incurred by APS should be reviewed for whether they have been prudently incurred.

B. The Emergency Relief Requested by APS and whether APS is experiencing a "Financial Emergency"

Q. Please summarize your understanding of the Emergency Rate Relief that has been requested by APS in this proceeding.

A. The Company's application indicates that APS is seeking an emergency rate increase of $299 million, or $14%, to be effective April 1, 2006, and subject to refund. Page 18 of APS's application claims that:

> "The Company is facing an operating cash flow emergency under any reasonable definition of that term. It is facing an imminent down grade to 'junk bond' status, which will make it unable to secure financing or transact business on reasonable terms and without very significant additional costs to APS customers. .... Clearly, now is the time for decisive and positive action to rectify the underlying cause of both these problems, namely the imbalance between base fuel revenues and current fuel and purchased power costs."

The basis for the amount of the emergency increase requested by APS is the Company's projected higher annual fuel and purchased power costs the Company expects to incur in 2006.

Q. Have any of the rating agencies discussed their outlook for APS's emergency interim filing?

A. Yes. S&P discussed its outlook and expectations for APS's emergency interim filing in a report issued January 24, 2006. See Attachment RCS-5. On the second page of that report, S&P stated that:

"What is the status with APS' emergency interim filing?

> On Jan. 6, 2006, APS filed a $299 million request for emergency fuel and purchased power-related rate relief. Any amounts, if granted, would be subject to future prudency review. As part of a procedural conference on Jan.12, four of the five commissioners questioned the definition of an emergency and whether relief is justified. Based on the strong views expressed, it appears unlikely that the filing has support. On Jan. 19, a procedural schedule was set that should allow for a decision in April 2006. Standard & Poor's forecast estimates do not assume emergency relief is granted."

S&P's January 24, 2006 report has stated that it appears unlikely that APS's emergency interim filing has support at the Commission, and S&P's forecast estimates do not assume emergency relief is granted. As noted above, a subsequent S&P report dated January 30, 2006 (see Attachment RCS-6), has nevertheless stated that the agency's outlook for APS and PNW is "stable."

Q. Does that S&P report also discuss the size and expectations for APS's deferrals of fuel and purchased power cost?

A. Yes. S&P's January 24, 2006 report discusses the estimated level of APS's deferred fuel and purchased power costs of approximately $165 million at January 31, 2006, and S&P's estimate that APS would likely incur an additional $250 million in fuel and purchased power costs in 2006 that are not recoverable in base electric rates. S&P states that:

> "The sum of balances to date of $165 million plus the expected incremental deferrals of $250 million total $415 million; however, because APS has the potential to collect some of its 2005 balances through a power supply adjustor (PSA) beginning April 1, year-end 2006 deferrals on the utility's balance sheet will not reach that level."

The S&P report also addresses ways in which S&P anticipates the fuel and purchased power deferrals accumulating at APS could be recovered. Notably, as mentioned above, S&P does not assume that the emergency rate relief requested by APS is granted, and S&P states that "it appears unlikely that the [APS emergency rate increase] filing has support."

Q. Does S&P's January 24, 2006, report discuss how APS's rating of BBB- relates to certain financial performance metrics?

A. Yes. This is discussed by S&P on the second page of its January 24, 2006 report.[7] APS's filing and testimony suggest that one particular financial metric, funds from operation as a percent of total debt ("FFO/Debt"), would cause the rating agencies to downgrade its credit standing to "junk" status.[8] However, while FFO/Debt is an important metric, this one measure by itself is not determinative of a bond rating. The January 24, 2006, S&P report explains that:

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[7] See Attachment RCS-5.
[8] See, e.g., APS's Application at pages 11-12.

> "FFO to total debt is an important metric for Standard & Poor's, and at a business profile of '6' (on a 10-point scale where '1' is excellent and '10' vulnerable), it reflects a below-investment-grade performance. For the 12 months ending Sept. 30, 2005, FFO interest coverage was 3.3x, which is reasonable for the current rating. Adjusted total debt to total capitalization was 53.1% and is solid for the current rating."

Thus, S&P reviews a number of financial metrics in the analytical process of establishing its ratings, and APS's other ratios, such as FFO interest coverage and debt to total capitalization, are reasonable or strong for the current rating. Staff witness Woolridge presents additional discussion regarding credit rating agency use of financial metrics in his prefiled direct testimony.

Q. Would the emergency rate relief that APS has requested necessarily prevent future downgrades of the Company's debt ratings?

A. No. There are at least two reasons why the emergency rate relief that APS has requested would not necessarily prevent future downgrades of the Company's debt ratings. First, any "emergency" rate increases granted in this proceeding would be subject to refund. Temporary refundable rate relief would thus only tend to postpone, and not prevent, further bond downgrades. Second, other factors, such as a sustained, unscheduled outage at the Palo Verde nuclear plant or one of APS's coal-fired generating facilities during a peak demand period could result in a downgrading. Fitch's January 30, 2006 report (provided in Attachment RCS-4), for example, mentions the operational risk and asset concentration of the Palo Verde nuclear plant as a concern and states that: "The facility has experienced intermittent operating problems over the past year and a sustained, unscheduled outage at the plant could lead to further negative rating actions."

Q. Has APS provided proof that granting its requested emergency rate relief would result in a bond rating upgrade?

A. No. APS has provided no proof that granting its requested emergency rate relief would result in a bond rating upgrade. STF 4.25 asked APS to: "Provide all quantitative analysis that APS has concerning the amount of additional annual revenues it would take to raise its bond rating up by one step." APS's response states:

> "No such specific analysis has been prepared. However, as stated at p. 13 of the Application the full amount of rate relief in addition to the annual PSA adjustments and an $80 million PSA Surcharge is need (sic) to bring the APS FFO to Debt ratio to 21%, which is in the lower half of the BBB ratings."

As explained elsewhere in my testimony and in additional detail in the testimony of Staff witness Woolridge, a particular FFO to Debt ratio does not, of itself, dictate a bond rating. Moreover, as shown in Attachment RCS-5, Standard & Poor's does not expect APS to be granted the emergency rate relief that APS has requested, but, as shown in Attachment RCS-6, lists the outlook for APS as "stable."

Q. Has APS's debt been downgraded to "junk" status?

A. No. APS's debt is still investment grade.

Q. What are APS's current bond ratings?

A. APS's response to STF 4.26 shows that APS's current long term debt ratings are:

S&P: BBB-

Moody's: Baa1

Fitch: BBB

Q. Has APS provided an estimate of how much its borrowing costs would increase if its long-term debt were to be downgraded to "junk" status?

A. Yes. APS's response to STF 1-14 explained why APS believed it was experiencing an "emergency." See Attachment RCS-8. As part of that response, APS states that:

> "A further downgrade of APS to 'junk bond' status will cost between $10-15 million in higher interest and other financing costs in 2006 with an escalating impact in future years such that the total cost increase to customers will be some $1 billion, if not more, over the next 10 years."

The testimony of Staff witness Woolridge addresses impacts on the Company's cost of capital associated with bond rating changes.

Q. Would a downgrading of APS's debt to "junk" status be a desirable outcome?

A. No, it would not. In addition to resulting in increased borrowing cost, such a downgrade could also impede the Company's access to credit.

Q. Does it appear imminent or probable that APS's debt will be downgraded to "junk" status if the $299 million emergency rate increase requested by APS is not granted?

A. No, it does not. After recent downgrades by investment rating agencies such as Standard & Poor's and Fitch, APS's debt is still investment grade and those agencies have listed their outlook for APS and PNW as "stable." See Attachments RCS-4 and RCS-6. Standard & Poor's has even stated that it does not expect APS's request for emergency rate relief to be granted and it is not reflected in S&P's estimates. See Attachment RCS-5.

Q. Has APS identified how its financing costs have increased as the result of S&P's rating downgrade to BBB-?

A. Yes. APS's response to STF 1-6 has identified approximately $1.027 million of increased annual interest cost associated with S&P's rating downgrade to BBB-. See Attachment RCS-7. Approximately $527,000 relates to increased costs of bank facilities and insurance, and $500,000 relates to a 25 basis point increase in borrowing cost on $200 million of commercial paper.

Q. How are a utility's interest costs charged to ratepayers?

A. In general, a utility's financing costs for debt are reflected in the weighted cost of debt in the capital structure. The debt cost is multiplied by the jurisdictional rate base and ratepayers pay for the interest cost as one of the components of the utility's cost of capital. Depending on how the utility accounts for them, some borrowing costs, such as bank fees, may be included in operating expenses.

The PSA that has been established for APS also includes a provision for financing cost.

Q. If APS's annual borrowing costs increase by $1 million, would that necessarily result in $1 million of additional annual financing costs to ratepayers?

A. No. However, if a utility's borrowing costs increase, eventually ratepayers may be required to pay for some portion of the increased costs when they are recognized in a rate case.

Q. Has APS provided proof that granting its requested emergency rate relief of $299 million would result in a cost savings to ratepayers?

A. No.

Q. Has APS defaulted on any bond indenture or credit arrangements?

A. It appears not. APS's responses to STF 4.7 and 4.8 list provisions in APS's indentures and credit arrangements that address minimum financial ratios and default conditions. See Attachments RCS-9 and RCS-10. The response to STF 4.7 states that "There are no provisions in any APS' indentures that address minimum financial ratios." That response also lists events of default. Notably, APS' application or testimony does not claim that a default has occurred. Nor do APS's responses to Staff data requests or the APS SEC filings that I have reviewed indicate that a default has occurred. A default would tend to be a "significant event" and would thus require reporting by APS and its parent company on SEC filings.

APS's response to STF 4.8 states that there are two provisions in APS's credit arrangement that address minimum financial ratios. The first one is that APS maintain Interest Coverage of at least two times. The second one is that APS's amount of debt does not exceed 65% of total capitalization. Calculations of coverage ratios provided in response to STF 4.48 show that with present rates, PSA deferrals but no PSA increase, APS is meeting both of these requirements.

Q. Is APS currently experiencing a "financial crisis" or "cash flow emergency"?

A. No. APS has claimed that it is in a "financial crisis"[9] and "is facing an operational cash flow emergency."[10] As explained in my and Staff witness Woolridge's testimony, APS is not currently experiencing a financial crisis and is not facing a cash flow emergency. Moreover, the Commission's action on January 25, 2006 in Decision No. 68437 to allow APS to defer 2006 fuel costs in excess of the $776.2 million cap and to implement a 4 mill

[9] See, e.g., APS Application, page 2, footnote 4.
[10] See, APS application at page 18.

PSA effective February 1, 2006 have already addressed some of APS's concerns regarding the build-up of a deferred PSA balance in 2006.

Q. Has APS proved that a $299 million emergency rate increase is needed?

A. No. APS has not demonstrated that its requested emergency rate relief would:

- prevent future downgrades of APS' debt ratings
- result in an upgrade of APS's debt ratings
- result in lower long-term costs for their customers, or
- be appropriate under the circumstances.

Q. Should the $299 million of emergency relief requested by APS be granted?

A. No. After the Commission's actions in Decision No. 68437, APS does not require a $299 million emergency rate increase at this time.

Q. If an emergency rate increase is not granted, how should APS's accumulation of deferred fuel costs be addressed?

A. Rather than grant APS emergency rate relief that is not needed, Staff recommends that the Commission should establish a means to address any deferred fuel balances that may be experienced by APS, as discussed later in my testimony.

C. Whether requirements should be placed on the Company as conditions for approval of all or part of its Emergency request.

Q. If any refundable emergency rate relief is granted in response to APS's current request, what safeguards are required?

A. I am not recommending that emergency rate relief be granted to APS in this proceeding. However, if the Commission were inclined to grant APS some amount of "emergency" rate relief, I have been advised by Staff counsel that current Arizona law would require posting of a bond by the utility as a legal requirement. Thus, granting emergency rate relief would result in an additional cost to APS and its ratepayers related to the cost of the surety bond.

Q. Has APS estimated what the cost of a surety bond would be?

A. Yes. In response to STF 4-41, APS estimates that the cost of a surety bond would be between .75 percent and 1 percent of the bond's value.

Q. Is there a way to avoid the extra cost of a surety bond to APS and its ratepayers?

A. Yes. Such cost could be avoided by denying APS's request for an emergency interim rate increase.

Q. If it were not for the legal requirement, would a surety bond appear to be necessary to assure that APS would have the ability financially to make refunds, or something you would recommend incurring an extra cost for?

A. No. I have not seen evidence in the instant proceeding or in APS's January 31, 2006 base rate case filing which suggests that APS is on the verge of bankruptcy, with or without its requested emergency relief. APS's current financial situation appears to be fairly healthy in many respects. Consequently, incurring additional cost for a surety bond does not appear necessary, given such circumstances.

Q. Whether or not any emergency rate increase is granted in this proceeding, should some reporting safeguards be imposed on APS?

A. Yes. Whether or not any emergency rate increase is granted in this proceeding, I recommend that the Commission temporarily impose some additional reporting safeguards on APS in order to monitor any deterioration in APS's financial condition. I recommend that the Commission require APS to file a monthly report on APS's and PWC's cash position and financial ratios, and their cash flow projections for the upcoming 12 months, and to notify the Commission immediately if any event occurs, or is projected by APS to occur within the next 12 months, which would constitute a default condition, such as those listed in APS's responses to STF 4-7 and 4-8.[11] By doing this, the Commission will have an additional means of keeping apprised of deterioration in APS's cash and financial situation.

D. Operation of the PSA as it Relates to APS's Request for an Emergency Rate Increase

Q. Please discuss how APS's request for $299 million of "emergency" rate relief relates to the recovery of fuel and purchase power costs through the base rates and PSA that was established by the Commission for APS in the utility's last rate case.

A. APS's request for $299 million of "emergency" rate relief appears to me to essentially be an attempt by the Company to supplement provisions in the PSA that were established by the Commission for APS in the utility's last rate case. APS's proposed emergency rate increase is essentially an <u>alternative</u> method of collecting for fuel and purchased power costs.

A press release from APS dated January 6, 2006, for example, states: **"The sole issue in this emergency rate filing is fuel and fuel alone."** A Securities and Exchange

[11] See Attachments RCS-9 and RCS-10.

Commission (SEC) combined Form 8-K dated January 6, 2006, filed by APS and its parent company, similarly described the reasons for APS's emergency interim rate increase of $299 million, or 14%, as being <u>solely</u> to address and <u>accelerate</u> the collection of fuel and purchased power costs:

> "**<u>The purpose of the emergency interim rate increase is solely to address APS' under-collection of higher annual fuel and purchased power costs</u>.** The increase would **<u>accelerate</u>** recovery of the fuel and purchased power component of APS' general rate case and is not an additional increase and would be subject to refund. The request for an emergency interim rate increase would not affect, and would be in addition to, APS' pending $80 million surcharge request and the annual PSA adjustment in April 2006."

(Emphasis supplied.)

Q. What significant features to the collection of fuel and purchased power costs does APS's emergency rate increase present?

A. In contrast with the method provided for collection of prudently incurred fuel and purchased power costs that the Commission has implemented for APS in Decision Nos. 67744 and 68437, the APS emergency rate increase:

(1) is based on increasing rates to accelerate collection of forecast estimates of fuel cost under-collections,

(2) would likely require incurring additional cost for a surety bond, and

(3) is based upon a claim that APS is currently experiencing a financial emergency and cash flow crisis.

Q. Among the various ways that the Commission could provide for APS to collect fuel and purchase power costs, is granting the Company's $299 million emergency rate increase request a preferred alternative?

A. No. Granting APS's requested emergency rate increase request for $299 million is not a preferred alternative because:

(1) it is based on increasing rates to accelerate collection of forecast estimates of fuel cost under-collections, rather than upon collection of actual costs already incurred;

(2) it would likely require incurring additional cost for a surety bond;

(3) APS has not proven that it is currently experiencing a financial emergency or cash flow crisis; and

(4) there is no assurance that increasing APS's rates by $299 million subject to refund would result in a bond rating upgrade or prevent a bond rating downgrade.

Q. What are some other alternatives for addressing APS's recovery of fuel and purchase power costs?

A. Alternatives for addressing APS's recovery of fuel and purchase power costs include: (1) allowing APS to address the build-up of deferred balances and the financial strain on APS that could be caused by carrying large deferred balances, or (2) allowing the existing fuel and purchased power cost recovery mechanism, including the PSA and the surcharge request process, to function as currently ordered by the Commission. The second alternative would essentially be a continuation of the current status quo.

Q. Which of these two alternatives is preferable?

A. In my opinion, the first alternative is preferable to the second because it provides for a means, other than another emergency rate increase request filing, for addressing recovery of APS's actual fuel and purchased power costs in a manner that is more likely to alleviate or prevent a financial crisis situation from developing later in 2006. The primary concern with the status quo is that it provides no interim means for addressing a large build-up in the annual tracking account before a decision in the rate case or before February 1, 2007. The mechanism recommended in the preferred alternative is more likely to avert the possibility of an emergency rate filing by APS later this year. By establishing a mechanism that would allow for earlier treatment of accumulated balances in the tracking account, the Commission would be positioned to act expeditiously if necessary. By providing a means of addressing such build-ups on a more timely basis, the preferred alternative may help to avert a financial crisis or additional credit downgrading later this year.

Q. Has APS demonstrated that its proposed $299 million emergency rate increase is a reasonable way of supplementing the existing PSA?

A. No. The PSA established by the Commission does not need to be supplemented at this time with a $299 million emergency rate increase for APS that would accelerate the collection of estimated future costs.

Q. Please discuss how the current PSA provides for the timing of when APS can file a request for a PSA surcharge?

A. The PSA <u>requires</u> APS to file a surcharge request under specified circumstances, such as within 45 days of the paragraph 19(d) additional recoverable or refundable balancing account exceeding plus or minus $50 million.[12] I have been advised that Decision No. 68437 effectively precludes APS from applying for a PSA surcharge for 2006 additional recoverable amounts recorded in the annual tracking account prior to February 1, 2007. It is Staff's understanding that, per Decision No. 68437, the Commission would view a surcharge request filed by APS prior to February 1, 2007 for 2006 amounts recorded in the annual tracking account as premature, but if APS filed for such a surcharge request after February 1, 2007, it would not be viewed as premature.

Q. Did APS file for a PSA surcharge in 2005?

A. Yes. As noted in Decision No. 68437, on July 22, 2005, APS filed an application for a PSA surcharge of $0.001770 per kWh. APS subsequently modified this request for recovery of $80 million over 24 months, with a surcharge of $0.001416 per kWh.

Q. What was Staff's recommendation concerning APS's request for a surcharge of $0.001416 per kWh?

A. Staff recommended that the surcharge of $0.001416 per kWh requested by APS be approved. Given the state of the natural gas market, Staff advised the Commission that the under-collected balance was likely to grow over the near term and denying or delaying the surcharge request would result in future surcharge requests of even greater magnitude. Staff also indicated that the approval of the surcharge would not impair the Commission's ability to consider whether the costs were imprudent or otherwise subject to disallowance and true-up or refund in a later rate case or other proceeding.

[12] A more detailed description of the requirement to file a surcharge is provided for in the PSA Plan of Administration. The Plan is currently being revised by the parties pursuant to the guidance provided in Decision No. 68437.

Q. Did the Commission appear to agree in principle that APS's under-collection of actual fuel costs should be addressed as soon as possible, rather than later?

A. Yes. Page 20 of Decision No. 68437 states:

> "Fuel and purchased power costs incurred by APS during the latter part of 2005 have escalated faster than the company anticipated. As a result, APS has accrued a significant undercollection for its fuel and purchase power costs. It is generally accepted that these costs will continue to mount in 2006. Under the circumstances and or at least the near future, the Commission agrees with Staff that APS' undercollection should be addressed as soon as possible instead of later. The most expeditious way to begin recovery is to change the timing of the reset for the adjustor. Therefore, we will allow APS to implement the annual Adjustor Rate on February 1 of each year."

Q. Does Staff continue to support the concept that addressing APS's under-collection as soon as possible rather than later is preferable?

A. Yes. Staff believes that prompt action on PSA surcharge requests is a better and more appropriate way to address the Company's growing deferred fuel balance than is the Company's request for emergency rate relief.

Q. Has APS recently filed for additional PSA surcharges?

A. Yes. On February 2, 2006, APS filed an application for two separate surcharges to recover a balance of $59.9 million in retail fuel and purchased power costs deferred by APS in 2005 under the PSA. The first surcharge would recover approximately $15.3 million over a 12-month period. The second surcharge requested by APS would recover approximately $44.6 million, also over a 12-month period. The $44.6 million represents PSA deferrals for replacement power cost associated with unplanned outages at Palo Verde from April 1, 2005 (the effective date of the PSA) through December 31, 2005.

Q. Did Standard & Poor's recent credit research on APS mention an expectation for a PSA surcharge request relating to the $59 million?

A. Yes. As shown in Attachment RCS-3, Standard & Poor's January 26, 2006 report addressed this and stated that:

> "The remaining $59 million will be addressed through a surcharge filing, which may be made only after Feb. 1, but for which the collection timeline and approval date are uncertain."

Q. Has concern been expressed regarding the timing of the Commission's action on PSA surcharge requests from APS?

A. Yes. As one example, as shown in Attachment RCS-3, Standard & Poor's January 26, 2006 report stated that:

> "While a technicality, the surcharge vote removes potential critical flexibility for timely recovery of prudently incurred fuel and purchased power costs. The PSA has a very narrow 4 mill per kilowatt-hour lifetime cap, and the ACC is not bound to act on a surcharge filing by any specific date. As a result, the ACC's decision could cause uncertainty over the timing and disposition of future, expected deferrals."

That S&P report notes further that the "very weak PSA" structure and the 4 mill lifetime cap results in transferring "any deferred balances to a surcharge process" which in turn "is open-ended, with no concrete timeline for resolution."

Q. Would prompt approval of some portion of the PSA surcharges filed by APS on February 2 be one means by which the Commission could address concerns regarding APS's deferred fuel costs?

A. Yes.

Q. Should the first surcharge requested in APS's February 2, 2006 application be promptly addressed?

A. Yes. The PSA surcharge application process is preferable to an emergency rate request as a means of addressing growing deferred fuel and purchased power costs. Prompt processing of this surcharge request could be viewed as a positive development by the credit rating agencies and investment community.

Q. What about the second component of APS's February 2, 2006 PSA surcharge request?

A. The second requested surcharge is for $0.001611 per kWh to recover $44.6 million for costs related to the 2005 unscheduled outages at Palo Verde that are being investigated in Docket No. E-01345A-05-0826. Questions remain regarding whether the unscheduled outages were prudent. Consequently, the Commission should reserve judgment regarding that PSA surcharge request until a determination is made whether the unscheduled Palo Verde outages were prudent and the resultant additional power costs resulting from those unscheduled outages were prudent and reasonable.

Q. Should the functioning of the current PSA be reexamined in the current APS rate case?

A. Yes. The PSA was implemented to apply to fuel and purchased power costs incurred on or after April 1, 2005. It is a relatively new adjustor and has not yet been operational for a full year. Some features of the PSA have been identified during the course of review in this proceeding which appear to deserve further review and discussion for potential improvement. I therefore recommend that the functioning of the PSA be reviewed in the current APS rate case and the PSA be revised if necessary in that case when the additional operating experience in 2006 can be taken into consideration.

Q. What does Staff recommend in the interim?

A. In order to address the potential for growing fuel cost under-collections that APS anticipates for 2006 when and if they are actually incurred and as a preferable alternative to an emergency rate increase, I recommend that the Commission allow APS to file for PSA surcharge requests in 2006 on a quarterly basis if necessary (i.e., that the Commission allow APS to file quarterly surcharge requests to amortize under- or over-recovered balances in the Annual Tracking Account).

I have been informed by Commission Staff that it is willing to expedite the processing of these surcharge requests. Staff envisions filing its recommendation no later than 30 days after APS' filing. Staff's ability to expedite its processing of APS' surcharge requests, however, depends upon APS' filing of a suitable application that at least addresses the items set forth subsequently in my testimony.

Q. When should APS be permitted to file the quarterly PSA surcharge requests?

A. APS should be permitted to file PSA surcharge requests in order to amortize its Annual Tracking Account not more frequently than quarterly. Staff is not recommending that the Commission **require** APS to file these quarterly surcharge requests; instead, Staff recommends that the Commission **permit** APS to do so in order to afford both the Company and the Commission the opportunity to address under-recovered balances before the 2007 reset. The first surcharge request should not be filed before June 30, 2006, and subsequent requests should not be filed before the end of each subsequent calendar quarter. APS should be permitted to file these quarterly surcharge requests until the Commission has issued a final order in APS' pending rate case. If APS elects to file a surcharge request, it should inform Staff of its intent to do so ten days before its filing.

Q. What information should be included in the quarterly PSA surcharge requests?

A. Any quarterly surcharge requests should include at a minimum the following information:

(1) the amount expected to be collected and how it relates to the most current month-end balance in the annual tracking account;

(2) the Company's proposed amortization period, including starting and ending dates, and the proposed surcharge rates expressed as a per-kWh charge;

(3) clear identification of how much of the proposed balance relates to replacement power costs for unscheduled plant outages.

(4) whether interest is requested;

(5) the impact upon customer bills;

(6) monthly forecasts of the Annual Tracking Account balance for the ensuing year; and

(7) a reconciliation of any differences between APS' monthly reports and the surcharge application.

Q. Please explain why you believe that this recommendation is appropriate at this time.

A. Providing for timely recovery of prudently incurred fuel and purchased power costs through a PSA surcharge process would be preferable to addressing fuel cost under-collections through emergency rate increases. APS's current request for a $299 million emergency rate increase should be rejected for the reasons described in my testimony. There is not a present financial crisis or cash flow emergency as suggested by APS. The Commission's January 25, 2007 Decision No. 68437 helped alleviate a financial crisis from developing at APS for the time being. However, a concern continues to exist regarding the build-up of deferred fuel balances in 2006 and the uncertain time frame for recovery of prudently incurred fuel and purchased power costs. This concern presents the possibility that APS may face circumstances that could implicate a financial crisis sometime in 2006. Allowing APS to make quarterly PSA surcharge filings, if necessary, in 2006 could thus function as a "safety valve" against financial pressure from carrying large deferred balances building to an emergency situation. It could thus help in avoiding an emergency situation from occurring later this year and could provide both the Commission and the Company with a ready means to address and prevent a potentially serious situation.

Commission Staff's willingness to file its recommendation regarding APS's surcharge requests within a specified time table would be an appropriate response to the presently existing lack of certainty about the time frame for consideration of such requests. This would be a simple step to address the lingering concern regarding timing. I also believe that setting such parameters would be viewed as a positive development by the rating agencies.

Q. Does this conclude your testimony?

A. Yes, it does.

Attachment RCS-1
QUALIFICATIONS OF RALPH C. SMITH

Accomplishments

Mr. Smith's professional credentials include being a Certified Financial Planner™ professional, a licensed Certified Public Accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. His involvement in public utility regulation has included project management and in-depth analyses of numerous issues involving telephone, electric, gas, and water and sewer utilities.

Mr. Smith has performed work in the field of utility regulation on behalf of industry, PSC staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Kentucky, Louisiana, Maine, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New York, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on several occasions.

Project manager in Larkin & Associates' review, on behalf of the Georgia Commission Staff, of the budget and planning activities of Georgia Power Company; supervised 13 professionals; coordinated over 200 interviews with Company budget center managers and executives; organized and edited voluminous audit report; presented testimony before the Commission. Functional areas covered included fossil plant O&M, headquarters and district operations, internal audit, legal, affiliated transactions, and responsibility reporting. All of our findings and recommendations were accepted by the Commission.

Key team member in the firm's management audit of the Anchorage Water and Wastewater Utility on behalf of the Alaska Commission Staff, which assessed the effectiveness of the Utility's operations in several areas; responsible for in-depth investigation and report writing in areas involving information systems, finance and accounting, affiliated relationships and transactions, and use of outside contractors. Testified before the Alaska Commission concerning certain areas of the audit report. AWWU concurred with each of Mr. Smith's 40 plus recommendations for improvement.

Co-consultant in the analysis of the issues surrounding gas transportation performed for the law firm of Cravath, Swaine & Moore in conjunction with the case of Reynolds Metals Co. vs. the Columbia Gas System, Inc.; drafted in-depth report concerning the regulatory treatment at both state and federal levels of issues such as flexible pricing and mandatory gas transportation.

Lead consultant and expert witness in the analysis of the rate increase request of the City of Austin - Electric Utility on behalf of the residential consumers. Among the numerous ratemaking issues addressed was the economies of the Utility's employment of outside services; provided both written and oral testimony outlining recommendations and their bases. Most of Mr. Smith's recommendations were adopted by the City Council and Utility in a settlement.

Key team member performing an analysis of the rate stabilization plan submitted by the Southern Bell Telephone & Telegraph Company to the Florida PSC; performed comprehensive analysis of the Company's projections and budgets which were used as the basis for establishing rates.

Lead consultant in analyzing Southwestern Bell Telephone separations in Missouri; sponsored the complex technical analysis and calculations upon which the firm's testimony in that case was based. He has also assisted in analyzing changes in depreciation methodology for setting telephone rates.

Lead consultant in the review of gas cost recovery reconciliation applications of Michigan Gas Utilities Company, Michigan Consolidated Gas Company, and Consumers Power Company. Drafted recommendations regarding the appropriate rate of interest to be applied to any over or under collections and the proper procedures and allocation methodology to be used to distribute any refunds to customer classes.

Lead consultant in the review of Consumers Power Company's gas cost recovery refund plan. Addressed appropriate interest rate and compounding procedures and proper allocation methodology.

Project manager in the review of the request by Central Maine Power Company for an increase in rates. The major area addressed was the propriety of the Company's ratemaking attrition adjustment in relation to its corporate budgets and projections.

Project manager in an engagement designed to address the impacts of the Tax Reform Act of 1986 on gas distribution utility operations of the Northern States Power Company. Analyzed the reduction in the corporate tax rate, uncollectibles reserve, ACRS, unbilled revenues, customer advances, CIAC, and timing of TRA-related impacts associated with the Company's tax liability.

Project manager and expert witness in the determination of the impacts of the Tax Reform Act of 1986 on the operations of Connecticut Natural Gas Company on behalf of the Connecticut Department of Public Utility Control - Prosecutorial Division, Connecticut Attorney General, and Connecticut Department of Consumer Counsel.

Lead Consultant for The Minnesota Department of Public Service ("DPS") to review the Minnesota Incentive Plan ("Incentive Plan") proposal presented by Northwestern Bell Telephone Company ("NWB") doing business as U S West Communications ("USWC"). Objective was to express an opinion as to whether current rates addressed by the plan were appropriate from a Minnesota intrastate revenue requirements and accounting perspective, and to assist in developing recommended modifications to NWB's proposed Plan.

Performed a variety of analytical and review tasks related to our work effort on this project. Obtained and reviewed data and performed other procedures as necessary (1) to obtain an understanding of the Company's Incentive Plan filing package as it relates to rate base, operating income, revenue requirements, and plan operation, and (2) to formulate an opinion concerning the reasonableness of current rates and of amounts included within the Company's Incentive Plan filing. These procedures included requesting and reviewing extensive discovery, visiting the Company's offices to review data, issuing follow-up information requests in many instances, telephone and on-site discussions with Company representatives, and frequent discussions with counsel and DPS Staff assigned to the project.

Lead Consultant in the regulatory analysis of Jersey Central Power & Light Company for the Department of the Public Advocate, Division of Rate Counsel. Tasks performed included on-site review and audit of Company, identification and analysis of specific issues, preparation of data requests, testimony, and cross examination questions. Testified in Hearings.

Assisted the NARUC Committee on Management Analysis with drafting the Consultant Standards for Management Audits.

Presented training seminars covering public utility accounting, tax reform, ratemaking, affiliated transaction auditing, rate case management, and regulatory policy in Maine, Georgia, Kentucky, and Pennsylvania. Seminars were presented to commission staffs and consumer interest groups.

Previous Positions

With Larkin, Chapski and Co., the predecessor firm to Larkin & Associates, was involved primarily in utility regulatory consulting, and also in tax planning and tax research for businesses and individuals, tax return preparation and review, and independent audit, review and preparation of financial statements.

Installed computerized accounting system for a realty management firm.

Education

Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979.

Master of Science in Taxation, Walsh College, Michigan, 1981. Master's thesis dealt with investment tax credit and property tax on various assets.

Juris Doctor, cum laude, Wayne State University Law School, Detroit, Michigan, 1986. Recipient of American Jurisprudence Award for academic excellence.

Continuing education required to maintain CPA license and CFP certificate.

Passed all parts of CPA examination in first sitting, 1979. Received CPA certificate in 1981 and Certified Financial Planning certificate in 1983. Admitted to Michigan and Federal bars in 1986.

Michigan Bar Association.

American Bar Association, sections on public utility law and taxation.

Partial list of utility cases participated in:

79-228-EL-FAC	Cincinnati Gas & Electric Company (Ohio PUC)
79-231-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
79-535-EL-AIR	East Ohio Gas Company (Ohio PUC)
80-235-EL-FAC	Ohio Edison Company (Ohio PUC)
80-240-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
U-1933*	Tucson Electric Power Company (Arizona Corp. Commission)
U-6794	Michigan Consolidated Gas Co. --16 Refunds (Michigan PSC)
81-0035TP	Southern Bell Telephone Company (Florida PSC)
81-0095TP	General Telephone Company of Florida (Florida PSC)
81-308-EL-EFC	Dayton Power & Light Co.- Fuel Adjustment Clause (Ohio PUC)
810136-EU	Gulf Power Company (Florida PSC)
GR-81-342	Northern States Power Co. -- E-002/Minnesota (Minnesota PUC)
Tr-81-208	Southwestern Bell Telephone Company (Missouri PSC))
U-6949	Detroit Edison Company (Michigan PSC)
8400	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
18328	Alabama Gas Corporation (Alabama PSC)
18416	Alabama Power Company (Alabama PSC)
820100-EU	Florida Power Corporation (Florida PSC)
8624	Kentucky Utilities (Kentucky PSC)
8648	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
U-7236	Detroit Edison - Burlington Northern Refund (Michigan PSC)
U6633-R	Detroit Edison - MRCS Program (Michigan PSC)
U-6797-R	Consumers Power Company -MRCS Program (Michigan PSC)

U-5510-R	Consumers Power Company - Energy conservation Finance Program (Michigan PSC)
82-240E	South Carolina Electric & Gas Company (South Carolina PSC)
7350	Generic Working Capital Hearing (Michigan PSC)
RH-1-83	Westcoast Transmission Co., (National Energy Board of Canada)
820294-TP	Southern Bell Telephone & Telegraph Co. (Florida PSC)
82-165-EL-EFC (Subfile A)	Toledo Edison Company(Ohio PUC)
82-168-EL-EFC	Cleveland Electric Illuminating Company (Ohio PUC)
830012-EU	Tampa Electric Company (Florida PSC)
U-7065	The Detroit Edison Company - Fermi II (Michigan PSC)
8738	Columbia Gas of Kentucky, Inc. (Kentucky PSC)
ER-83-206	Arkansas Power & Light Company (Missouri PSC)
U-4758	The Detroit Edison Company – Refunds (Michigan PSC)
8836	Kentucky American Water Company (Kentucky PSC)
8839	Western Kentucky Gas Company (Kentucky PSC)
83-07-15	Connecticut Light & Power Co. (Connecticut DPU)
81-0485-WS	Palm Coast Utility Corporation (Florida PSC)
U-7650	Consumers Power Co. - Partial and Immediate (Michigan PSC)
83-662	Continental Telephone Company of California, (Nevada PSC)
U-7650	Consumers Power Company – Final (Michigan PSC)
U-6488-R	Detroit Edison Co., FAC & PIPAC Reconciliation (Michigan PSC)
U-15684	Louisiana Power & Light Company (Louisiana PSC)
7395 & U-7397	Campaign Ballot Proposals (Michigan PSC)
820013-WS	Seacoast Utilities (Florida PSC)
U-7660	Detroit Edison Company (Michigan PSC)
83-1039	CP National Corporation (Nevada PSC)
U-7802	Michigan Gas Utilities Company (Michigan PSC)
83-1226	Sierra Pacific Power Company (Nevada PSC)
830465-EI	Florida Power & Light Company (Florida PSC)
U-7777	Michigan Consolidated Gas Company (Michigan PSC)
U-7779	Consumers Power Company (Michigan PSC)
U-7480-R	Michigan Consolidated Gas Company (Michigan PSC)
U-7488-R	Consumers Power Company – Gas (Michigan PSC)
U-7484-R	Michigan Gas Utilities Company (Michigan PSC)
U-7550-R	Detroit Edison Company (Michigan PSC)
U-7477-R**	Indiana & Michigan Electric Company (Michigan PSC)
18978	Continental Telephone Co. of the South Alabama (Alabama PSC)
R-842583	Duquesne Light Company (Pennsylvania PUC)
R-842740	Pennsylvania Power Company (Pennsylvania PUC)
850050-EI	Tampa Electric Company (Florida PSC)
16091	Louisiana Power & Light Company (Louisiana PSC)
19297	Continental Telephone Co. of the South Alabama (Alabama PSC)
76-18788AA &76-18793AA	Detroit Edison - Refund - Appeal of U-4807 (Ingham County, Michigan Circuit Court)
85-53476AA & 85-534785AA	Detroit Edison Refund - Appeal of U-4758 (Ingham County, Michigan Circuit Court)
U-8091/U-8239	Consumers Power Company - Gas Refunds (Michigan PSC)
TR-85-179**	United Telephone Company of Missouri (Missouri PSC)
85-212	Central Maine Power Company (Maine PSC)
ER-85646001 & ER-85647001	New England Power Company (FERC)
850782-EI & 850783-EI	Florida Power & Light Company (Florida PSC)
R-860378	Duquesne Light Company (Pennsylvania PUC)

R-850267	Pennsylvania Power Company (Pennsylvania PUC)
851007-WU & 840419-SU	Florida Cities Water Company (Florida PSC)
G-002/GR-86-160	Northern States Power Company (Minnesota PSC)
7195 (Interim)	Gulf States Utilities Company (Texas PUC)
87-01-03	Connecticut Natural Gas Company (Connecticut PUC))
87-01-02	Southern New England Telephone Company (Connecticut Department of Public Utility Control)
R-860378	Duquesne Light Company Surrebuttal (Pennsylvania PUC)
3673-	Georgia Power Company (Georgia PSC)
29484	Long Island Lighting Co. (New York Dept. of Public Service)
U-8924	Consumers Power Company – Gas (Michigan PSC)
Docket No. 1	Austin Electric Utility (City of Austin, Texas)
Docket E-2, Sub 527	Carolina Power & Light Company (North Carolina PUC)
870853	Pennsylvania Gas and Water Company (Pennsylvania PUC)
880069**	Southern Bell Telephone Company (Florida PSC)
U-1954-88-102 T E-1032-88-102	Citizens Utilities Rural Company, Inc. & Citizens Utilities Company, Kingman Telephone Division (Arizona CC)
89-0033	Illinois Bell Telephone Company (Illinois CC)
U-89-2688-T	Puget Sound Power & Light Company (Washington UTC))
R-891364	Philadelphia Electric Company (Pennsylvania PUC)
F.C. 889	Potomac Electric Power Company (District of Columbia PSC)
Case No. 88/546*	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+Western, Inc. et al, defendants (Supreme Court County of Onondaga, State of New York)
87-11628*	Duquesne Light Company, et al, plaintiffs, against Gulf+ Western, Inc. et al, defendants (Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
890319-EI	Florida Power & Light Company (Florida PSC)
891345-EI	Gulf Power Company (Florida PSC)
ER 8811 0912J	Jersey Central Power & Light Company (BPU)
6531	Hawaiian Electric Company (Hawaii PUCs)
R0901595	Equitable Gas Company (Pennsylvania Consumer Counsel)
90-10	Artesian Water Company (Delaware PSC)
89-12-05	Southern New England Telephone Company (Connecticut PUC)
900329-WS	Southern States Utilities, Inc. (Florida PSC)
90-12-018	Southern California Edison Company (California PUC)
90-E-1185	Long Island Lighting Company (New York DPS)
R-911966	Pennsylvania Gas & Water Company (Pennsylvania PUC)
I.90-07-037, Phase II	(Investigation of OPEBs) Department of the Navy and all Other Federal Executive Agencies (California PUC)
U-1551-90-322	Southwest Gas Corporation (Arizona CC)
U-1656-91-134	Sun City Water Company (Arizona RUCO)
U-2013-91-133	Havasu Water Company (Arizona RUCO)
91-174***	Central Maine Power Company (Department of the Navy and all Other Federal Executive Agencies)
U-1551-89-102 & U-1551-89-103	Southwest Gas Corporation - Rebuttal and PGA Audit (Arizona Corporation Commission)
Docket No. 6998	Hawaiian Electric Company (Hawaii PUC)
TC-91-040A and TC-91-040B	Intrastate Access Charge Methodology, Pool and Rates Local Exchange Carriers Association and South Dakota Independent Telephone Coalition
9911030-WS & 911-67-WS	General Development Utilities - Port Malabar and West Coast Divisions (Florida PSC)
922180	The Peoples Natural Gas Company (Pennsylvania PUC)
7233 and 7243	Hawaiian Nonpension Postretirement Benefits (Hawaiian PUC)

R-00922314 & M-920313C006	Metropolitan Edison Company (Pennsylvania PUC)
R00922428	Pennsylvania American Water Company (Pennsylvania PUC)
E-1032-92-083 & U-1656-92-183	Citizens Utilities Company, Agua Fria Water Division (Arizona Corporation Commission)
92-09-19	Southern New England Telephone Company (Connecticut PUC)
E-1032-92-073	Citizens Utilities Company (Electric Division), (Arizona CC)
UE-92-1262	Puget Sound Power and Light Company (Washington UTC))
92-345	Central Maine Power Company (Maine PUC)
R-932667	Pennsylvania Gas & Water Company (Pennsylvania PUC)
U-93-60**	Matanuska Telephone Association, Inc. (Alaska PUC)
U-93-50**	Anchorage Telephone Utility (Alaska PUC)
U-93-64	PTI Communications (Alaska PUC)
7700	Hawaiian Electric Company, Inc. (Hawaii PUC)
E-1032-93-111 & U-1032-93-193	Citizens Utilities Company - Gas Division (Arizona Corporation Commission
R-00932670	Pennsylvania American Water Company (Pennsylvania PUC)
U-1514-93-169/ E-1032-93-169	Sale of Assets CC&N from Contel of the West, Inc. to Citizens Utilities Company (Arizona Corporation Commission)
7766	Hawaiian Electric Company, Inc. (Hawaii PUC)
93-2006- GA-AIR*	The East Ohio Gas Company (Ohio PUC)
94-E-0334	Consolidated Edison Company (New York DPS)
94-0270	Inter-State Water Company (Illinois Commerce Commission)
94-0097	Citizens Utilities Company, Kauai Electric Division (Hawaii PUC)
PU-314-94-688	Application for Transfer of Local Exchanges (North Dakota PSC)
94-12-005-Phase I	Pacific Gas & Electric Company (California PUC)
R-953297	UGI Utilities, Inc. - Gas Division (Pennsylvania PUC)
95-03-01	Southern New England Telephone Company (Connecticut PUC)
95-0342	Consumer Illinois Water, Kankakee Water District (Illinois CC)
94-996-EL-AIR	Ohio Power Company (Ohio PUC)
95-1000-E	South Carolina Electric & Gas Company (South Carolina PSC)
Non-Docketed Staff Investigation	Citizens Utility Company - Arizona Telephone Operations (Arizona Corporation Commission)
E-1032-95-473	Citizens Utility Co. - Northern Arizona Gas Division (Arizona CC)
E-1032-95-433	Citizens Utility Co. - Arizona Electric Division (Arizona CC)
	Collaborative Ratemaking Process Columbia Gas of Pennsylvania (Pennsylvania PUC)
GR-96-285	Missouri Gas Energy (Missouri PSC)
94-10-45	Southern New England Telephone Company (Connecticut PUC)
A.96-08-001 et al.	California Utilities' Applications to Identify Sunk Costs of Non-Nuclear Generation Assets, & Transition Costs for Electric Utility Restructuring, & Consolidated Proceedings (California PUC)
96-324	Bell Atlantic - Delaware, Inc. (Delaware PSC)
96-08-070, et al.	Pacific Gas & Electric Co., Southern California Edison Co. and San Diego Gas & Electric Company (California PUC)
97-05-12	Connecticut Light & Power (Connecticut PUC)
R-00973953	Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code (Pennsylvania PUC)
97-65	Application of Delmarva Power &Light Co. for Application of a Cost Accounting Manual and a Code of Conduct (Delaware PSC)
16705	Entergy Gulf States, Inc. (Cities Steering Committee)
E-1072-97-067	Southwestern Telephone Co. (Arizona Corporation Commission)
Non-Docketed Staff Investigation	Delaware - Estimate Impact of Universal Services Issues (Delaware PSC)

PU-314-97-12	US West Communications, Inc. Cost Studies (North Dakota PSC)
97-0351	Consumer Illinois Water Company (Illinois CC)
97-8001	Investigation of Issues to be Considered as a Result of Restructuring of Electric Industry (Nevada PSC)
U-0000-94-165	Generic Docket to Consider Competition in the Provision of Retail Electric Service (Arizona Corporation Commission)
98-05-006-Phase I	San Diego Gas & Electric Co., Section 386 costs (California PUC)
9355-U	Georgia Power Company Rate Case (Georgia PUC)
97-12-020 - Phase I	Pacific Gas & Electric Company (California PUC)
U-98-56, U-98-60, U-98-65, U-98-67	Investigation of 1998 Intrastate Access charge filings (Alaska PUC)
(U-99-66, U-99-65, U-99-56, U-99-52)	Investigation of 1999 Intrastate Access Charge filing (Alaska PUC)
Phase II of 97-SCCC-149-GIT	Southwestern Bell Telephone Company Cost Studies (Kansas CC)
PU-314-97-465	US West Universal Service Cost Model (North Dakota PSC)
Non-docketed Assistance	Bell Atlantic - Delaware, Inc., Review of New Telecomm. and Tariff Filings (Delaware PSC)
Contract Dispute	City of Zeeland, MI - Water Contract with the City of Holland, MI (Before an arbitration panel)
Non-docketed Project	City of Danville, IL - Valuation of Water System (Danville, IL)
Non-docketed Project	Village of University Park, IL - Valuation of Water and Sewer System (Village of University Park, Illinois)
E-1032-95-417	Citizens Utility Co., Maricopa Water/Wastewater Companies et al. (Arizona Corporation Commission)
T-1051B-99-0497	Proposed Merger of the Parent Corporation of Qwest Communications Corporation, LCI International Telecom Corp., and US West Communications, Inc. (Arizona CC)
T-01051B-99-0105	US West Communications, Inc. Rate Case (Arizona CC)
A00-07-043	Pacific Gas & Electric - 2001 Attrition (California PUC)
T-01051B-99-0499	US West/Quest Broadband Asset Transfer (Arizona CC)
99-419/420	US West, Inc. Toll and Access Rebalancing (North Dakota PSC)
PU314-99-119	US West, Inc. Residential Rate Increase and Cost Study Review (North Dakota PSC
98-0252	Ameritech - Illinois, Review of Alternative Regulation Plan (Illinois CUB)
00-108	Delmarva Billing System Investigation (Delaware PSC)
U-00-28	Matanuska Telephone Association (Alaska PUC)
Non-Docketed	Management Audit and Market Power Mitigation Analysis of the Merged Gas System Operation of Pacific Enterprises and Enova Corporation (California PUC)
00-11-038	Southern California Edison (California PUC)
00-11-056	Pacific Gas & Electric (California PUC)
00-10-028	The Utility Reform Network for Modification of Resolution E-3527 (California PUC)
98-479	Delmarva Power & Light Application for Approval of its Electric and Fuel Adjustments Costs (Delaware PSC)
99-457	Delaware Electric Cooperative Restructuring Filing (Delaware PSC)
99-582	Delmarva Power & Light dba Conectiv Power Delivery Analysis of Code of Conduct and Cost Accounting Manual (Delaware PSC)
99-03-04	United Illuminating Company Recovery of Stranded Costs (Connecticut OCC)
99-03-36	Connecticut Light & Power (Connecticut OCC)
Civil Action No. 98-1117	West Penn Power Company vs. PA PUC (Pennsylvania PSC)

Case No. 12604	Upper Peninsula Power Company (Michigan AG)
Case No. 12613	Wisconsin Public Service Commission (Michigan AG)
41651	Northern Indiana Public Service Co Overearnings investigation (Indiana UCC)
13605-U	Savannah Electric & Power Company – FCR (Georgia PSC)
14000-U	Georgia Power Company Rate Case/M&S Review (Georgia PSC)
13196-U	Savannah Electric & Power Company Natural Gas Procurement and Risk Management/Hedging Proposal, Docket No. 13196-U (Georgia PSC)
Non-Docketed	Georgia Power Company & Savannah Electric & Power FPR Company Fuel Procurement Audit (Georgia PSC)
Non-Docketed	Transition Costs of Nevada Vertically Integrated Utilities (US Department of Navy)
Application No. 99-01-016,	Post-Transition Ratemaking Mechanisms for the Electric Industry Restructuring (US Department of Navy)
Phase I	
99-02-05	Connecticut Light & Power (Connecticut OCC)
01-05-19-RE03	Yankee Gas Service Application for a Rate Increase, Phase I-2002-IERM (Connecticut OCC)
G-01551A-00-0309	Southwest Gas Corporation, Application to amend its rate Schedules (Arizona CC)
00-07-043	Pacific Gas & Electric Company Attrition & Application for a rate increase (California PUC)
97-12-020	
Phase II	Pacific Gas & Electric Company Rate Case (California PUC)
01-10-10	United Illuminating Company (Connecticut OCC)
13711-U	Georgia Power FCR (Georgia PSC)
02-001	Verizon Delaware § 271(Delaware DPA)
02-BLVT-377-AUD	Blue Valley Telephone Company Audit/General Rate Investigation (Kansas CC)
02-S&TT-390-AUD	S&T Telephone Cooperative Audit/General Rate Investigation (Kansas CC)
01-SFLT-879-AUD	Sunflower Telephone Company Inc., Audit/General Rate Investigation (Kansas CC)
01-BSTT-878-AUD	Bluestem Telephone Company, Inc. Audit/General Rate Investigation (Kansas CC)
P404, 407, 520, 413 426, 427, 430, 421/	
CI-00-712	Sherburne County Rural Telephone Company, dba as Connections, Etc. (Minnesota DOC)
U-01-85	ACS of Alaska, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-34	ACS of Anchorage, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-83	ACS of Fairbanks, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-87	ACS of the Northland, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
96-324, Phase II	Verizon Delaware, Inc. UNE Rate Filing (Delaware PSC)
03-WHST-503-AUD	Wheat State Telephone Company (Kansas CC)
04-GNBT-130-AUD	Golden Belt Telephone Association (Kansas CC)
Docket 6914	Shoreham Telephone Company, Inc. (Vermont BPU)

ARIZONA CORPORATION COMMISSION STAFF'S
FIRST SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
RE: DOCKET NO. E-01345A-06-0009
JANUARY 11, 2006

STF 1-11 On page 3 line 12 of the application you state that the $776.2 million cap is likely to be exceeded in the fourth quarter of 2006. Please provide work papers that support this projection. Please include a list of all assumptions and forecasts of fuel and purchase power costs by month

Response:

The forecast of fuel and purchased power is based on the Company's 2006 Fuel Budget, with fuel and purchased power prices and hedge value updates as of the November 30th market. Details of this fuel and purchased power forecast are provided in attachment STF 1-11b as APS07170 which are confidential and being provided pursuant to a Protective Agreement

APS' projected native load fuel and purchased power costs in 2006 total $901,509,000 before off-system margin of $8,298,000. After netting these numbers, adjusting for the Sundance fuel savings deferral, removing ISFSI costs and FAS133 mark to market adjustments, the costs are allocated between retail and wholesale customers. The Retail Net Fuel and Purchased Power Cost on line 21 of attachment STF 1-11a as APS07169 which are confidential and being provided pursuant to a Protective Agreement shows the monthly cumulative fuel and purchased power cost for 2006, which reaches $804,600,000 by the end of November, and is projected to be $848,960,000 by the end of 2006.

Please note that this number is different from the figure in 1.9 because the former does not reflect the normalizations and annualizations customarily done in rate cases, including the Company's last rate proceeding.

STANDARD &POOR'S | RATINGSDIRECT

RESEARCH

Research Update: APS, PWCC's 'BBB-' Corporate Credit Ratings Affirmed On ACC Vote But Challenges Continue

Publication date: 26-Jan-2006
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB-/Stable/A-3

Rationale

Standard & Poor's Ratings Services affirmed its 'BBB-' corporate credit ratings on Arizona Public Service (APS) and its parent, Pinnacle West Capital Corp. (PWCC), following the generally constructive decisions made by the Arizona Corporation Commission (ACC) on Jan. 25. The commission lifted a cap that limited APS' opportunity to recover fuel and purchased power costs and modestly advanced the collection of deferred costs that APS was incurring under the terms of its power supply adjuster (PSA). However, the ACC also restricted APS' ability to file for a surcharge, which raises certain credit concerns. The outlook is stable.

The ACC vote to remove the $776 million cap on annual fuel and purchased power costs is favorable because it allows APS to defer any costs that exceed this level, which is in fact expected to occur in late 2006. APS' current deferral level is about $170 million, which will likely increase by approximately $250 million this year. The ACC adopted an amendment to advance the commencement of recovery of these costs by two months to Feb. 1 from April 1. While the impact is small, providing APS only about $14 million of incremental recovery in 2006, the vote is an important indicator that the ACC acknowledges that timely action is necessary to limit cash flow pressure on the company. (Note: As a result of staff and company testimony, some of the numbers Standard & Poor's cited in its Jan. 25 credit FAQ have been updated here.)

However, the ACC also voted to prohibit APS from requesting surcharges before the annual PSA adjustor is implemented. Heretofore, Standard & Poor's understood that APS would be permitted to file for surcharge relief any time that deferrals reached $100 million, as appeared to be implied by the settlement in its last rate case, as amended by the ACC in March 2005. With respect to the $170 million of deferrals that have accumulated as of year-end 2005, the recently enacted PSA adjuster will generate only about $111 million over the next 12 months. The remaining $59 million will be addressed through a surcharge filing, which may be made only after Feb. 1, but for which the collection timeline and approval date are uncertain.

While a technicality, the surcharge vote removes potentially critical flexibility for timely recovery of prudently incurred fuel and purchased power costs. The PSA has a very narrow 4 mill per kilowatt-hour lifetime cap, and the ACC is not bound to act on a surcharge filing by any specific date. As a result, the ACC's decision could cause uncertainty over the timing and disposition of future, expected deferrals.

Standard & Poor's current expectation is that high fuel and purchased power costs will result in a 2006 deferral problem that is larger than that of 2005. The ACC's vote to limit the flexibility of the timing of the surcharge elevates the importance of APS' request for $299 million in interim emergency rate relief, which is expected to be ruled on in April. That is, a limited PSA with a backstop surcharge that can be filed according to a specified timeline places incremental pressure on other processes that could support credit quality through 2006, especially when permanent rate relief via a general rate case ruling is not expected to occur within the next year.

Much of these issues stem from the very weak PSA, which is triggered based on a date and not on a threshold level of deferrals and which limits any adjustment to a narrow cap. This structure transfers any deferred balances to a surcharge process. In turn, the surcharge process is open-ended, with no concrete timeline for resolution. At the same time, APS has a significant reliance on natural gas. And this dependence is expected to grow in the coming years. Given the volatility of this fuel and expectations that at least in the near-term prices will remain high relative to historic levels--certainly relative to 2003 levels on which current retail rates are based--a critical underpinning of credit quality is the timing of recovery. This emphasis is particularly important in Arizona, where there is little precedent to support the conclusion that general rate cases can be processed quickly.

However, despite the emphasis that Standard & Poor's places on power supply adjustment mechanisms, it is possible that if the ACC establishes a track record of being supportive and timely toward emergency rate relief requests, that this vehicle could compensate for the current limitations of APS' PSA.

Outlook

The stable outlook is premised on the ACC providing sustained regulatory support that adequately addresses building deferrals. Negative rating actions could result if regulatory support does not continue, or if market forces or operational issues lead to significant increases in the expected 2006 deferral level.

Ratings List

Pinnacle West Capital Corp.	
Corp credit rating	BBB-/Stable/A-3
Senior unsecured debt	BB+
Commercial paper	A-3
Arizona Public Service Co.	
Corp credit rating	BBB-/Stable/A-3
Senior unsecured debt	BBB-
PVNGS II funding Corp Inc.	BBB-
Commercial paper	A-3

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

Fitch Lowers PNW & APS' Sr. Unsecured Ratings to 'BBB-' & 'BBB', Respectively; Outlook Stable

Ratings
30 Jan 2006 4:23 PM (EST)

Fitch Ratings-New York-30 January 2006: Fitch Ratings has lowered Pinnacle West Capital's (PNW) long- and short-term ratings. At the same time, Fitch has lowered Arizona Public Service Company's (APS) long-term ratings, while affirming its commercial paper rating. The securities of PNW and APS have been removed from Rating Watch Negative, where they were placed Jan. 6, 2006. The Rating Outlook is Stable. The following actions are effective immediately:

Pinnacle West Capital:

--Issuer default rating (IDR) downgraded to 'BBB-' from 'BBB';
--Senior unsecured debt downgraded to 'BBB-' from 'BBB';
--Commercial Paper downgraded to 'F3' from 'F2'.

The Rating Outlook is Stable.

Arizona Public Service Co.

--IDR downgraded to 'BBB-' from 'BBB';
--Senior unsecured debt downgraded to 'BBB' from 'BBB+';
--Commercial Paper affirmed at 'F2'.

The Rating Outlook is Stable.

Approximately $3.8 billion of debt is affected by the rating actions.

The rating actions and Stable Rating Outlook reflect the resolution of APS' power supply adjustor (PSA) proceedings by the Arizona Corporation Commission (ACC) and the utility's significant exposure to high and rising natural gas commodity costs. The commodity exposure is a function of a generating capacity mix, about half of which is natural gas fired, and rapid service territory load growth, which is likely to be met predominantly by natural gas-fired resources. The revised ratings also consider the operational risk and asset concentration of the Palo Verde nuclear plant. The facility has experienced intermittent operating problems over the past year and a sustained, unscheduled outage at the plant could lead to further negative rating actions.

The ACC decision in the PSA proceedings, issued on Jan. 25, 2006, has positive and negative implications for PNW and APS' creditworthiness. The commission's decision to accelerate the effective date of the PSA rate to Feb. 1 from April 1, along with the removal of the $776 million annual power supply cost limit, were constructive developments in Fitch's view. However, the ACC bench order rejecting APS's $80 million surcharge request on procedural grounds and restriction of PSA adjustments to an annual reset is less favorable than Fitch had anticipated in its previous ratings and is a significant source of concern for PNW and APS fixed-income investors. The fact that there is no vehicle within the PSA protocol to recover supply costs more frequently than annually during periods of sustained high and rising energy costs subjects APS to significant cash flow volatility and working capital requirements. Such costs would be exacerbated in a meaningful way by an extended outage of a base load nuclear- or coal-fired generating facility during periods of peak demand. The only option to recover fuel and purchase power costs above amounts determined annually in the PSA would be an emergency rate filing, in which the timing and amount of rate relief would be uncertain.

It is Fitch's understanding that energy cost deferrals in a particular year of up to four mills per kilowatt hour (approximately $110 million-$115 million on an annual run rate) will be recovered through an annual PSA rate adjustment that will recover those costs over the following 12 months. The surcharge is expected to facilitate recovery of costs in excess of the four mills per kilowatt hour limit over a time horizon to be determined by the commission.

Contact: Philip Smyth, CFA +1-212-908-0531 or Robert Hornick +1-212-908-0523, New York.

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Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, 'www.fitchratings.com'. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site.

STANDARD &POOR'S | RATINGSDIRECT

RESEARCH

Credit FAQ: Credit Issues Expected To Continue For Pinnacle West Capital Corp. And Arizona Public Service Co.

Publication date: 24-Jan-2006
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

On Dec. 21, 2005, Standard & Poor's Ratings Services lowered the corporate credit ratings on Arizona Public Service Co. (APS) and its parent, Pinnacle West Capital Corp. (PWCC) by one notch to 'BBB-'. This action reflected three factors: growing fuel and purchased power deferrals, which are weakening financial performance in 2005 and 2006, the lack of action by the Arizona Corporation Commission (ACC) in 2005 to address a portion of these deferrals through a special surcharge, and the likelihood of delays in the completion of APS' recent general rate case (GRC) filing, which suggest that financial weakening may extend into 2007.

Standard & Poor's stated at the time that any adverse regulatory developments or continued delays in resolving the pending surcharge request could trigger another rating action, which could include a revision of the stable rating outlook to negative, placing the company's debt rating on CreditWatch with negative implications, or lowering the rating to non-investment grade.

Frequently Asked Questions

How large are APS' deferrals of fuel and purchased power?
At Jan. 31, 2006, APS' estimated fuel and purchased power deferrals are expected to be about $165 million. These deferrals are accumulating because APS' base electric rates are set to reflect 2003 costs, and power and natural gas costs have far exceeded these rates. APS collects 2.0473 cents per kilowatt-hour (kWh) in rates for these costs, but for the 12 months ended September 2005, its actual cost averaged 2.701 cents per kWh. Because these rates will not be updated until the completion of APS' recently filed GRC or the emergency interim request, deferrals will likely continue to accumulate in 2006 and into 2007.

The amount by which 2006 actual fuel and purchased power costs will exceed the authorized expenditures will be a function of retail sales growth, commodity costs, the operational performance of APS' generation assets, and the fuel-in-base factor. Standard & Poor's has estimated that, at year-end 2006, the utility will likely incur an additional $250 million in fuel and purchased power costs that are not recoverable in base electric rates. The sum of balances to date of $165 million plus the expected incremental deferrals of $250 million total $415 million; however, because APS has the potential to collect some of its 2005 balances through a power supply adjuster (PSA) beginning April 1, year-end 2006 deferrals on the utility's balance sheet will not reach that level.

What are the ways that APS could recover its expected deferrals?

Under the terms of a settlement reached in APS' 2003 rate case approved by the ACC in April 2005, the PSA may be increased as much as four mills per kWh (a cap over the life of the PSA) on April 1, 2006. Using 2005 retail sales, and assuming a 4.5% growth rate (which is consistent with recent results), the four mills should yield about $125 million in rate relief on an annualized basis, or about $83 million for the eight months of 2006. Thus, as a rough approximation, APS' deferred balance would be about $330 million at year-end 2006.

On Jan. 17, the chairman of the ACC introduced a proposal to accelerate the PSA adjustment to Feb. 1. If this were approved by the ACC, an additional two months of the PSA would provide about $20 million in incremental revenues (e.g., roughly $125 million multiplied by two-twelfths of the year) in 2006. Thus, if the Hatch-Miller amendment moves forward, year-end 2006 deferred balances will be closer to about $310 million. The amendment is expected to be discussed on Jan. 24.

Additional relief could be provided if the ACC grants APS' request to recover $80 million by means of a two-year special surcharge that would increase retail rates by about 2%. On Jan. 4, an administrative law judge issued a decision indicating that APS' surcharge application is premature until the company's first power supply adjustment occurs in April. An ACC vote is scheduled for Jan. 24. Standard & Poor's current assumption is that the surcharge will be approved by the ACC, but will be delayed until July 1, 2006. A surcharge implemented at this time would provide roughly an additional $20 million to the company in 2006. If it were implemented sooner, the impact on deferrals would be relatively small, providing about $3 million in each month it is in place during 2006. If the Hatch-Miller amendment were approved and a surcharge was implemented and approved for Feb. 1, the two measures collectively would bring between $50 million-$57 million in relief. Accordingly, relative to the year-end expected balances, an accelerated surcharge and PSA, if granted, will reduce deferrals but only by about 20% in the best-case scenario.

What is the status with APS' emergency interim filing?
On Jan. 6, 2006, APS filed a $299 million request for emergency fuel and purchased power-related rate relief. Any amounts, if granted, would be subject to future prudency review. As part of a procedural conference on Jan. 12, four of the five commissioners questioned the definition an emergency and whether relief is justified. Based on the strong views expressed, it appears unlikely that the filing has support. On Jan. 19, a procedural schedule was set that should allow for a decision in April 2006. Standard & Poor's forecast estimates do not assume emergency relief is granted.

Are there credit concerns related to APS' rate cap?
Balancing these potential sources of rate relief are additional adverse financial effects that could occur for APS if its "hard cap" of $776 million is not lifted. The cap is part of APS' 2004 settlement, approved by the ACC in April 2005, which restricts the total amount of annual fuel and purchased power costs that can be collected in retail rates. APS expects that its fuel and purchased power costs will exceed the cap in the fourth quarter of 2006, and has indicated publicly that its estimated fuel costs will exceed $800 million. As part of its emergency interim filing, APS has requested that the cap be removed. If the cap is not lifted, any amounts above $776 million would be unrecoverable, putting further pressure on cash flows.

What assumptions does Standard & Poor's make about the performance of APS' generation assets in estimating deferred balances?
Standard & Poor's estimates assume normal operational performance of APS' generation fleet. Forced outages could increase deferred balances. Palo Verde unit 1 is in the process of exiting an outage that occurred last week due to pipe vibrations within the emergency cooling system. APS took the unit offline last week to install clamps in an effort to stop the excess vibrations. From late December until Jan. 17, unit 1 has operated at about 30% capacity while crews have tried to fix the problem, which followed the completion of the unit's exit from a refueling and maintenance outage begun in the fall of 2005. The plant is expected to maintain approximately this level of reduced capacity while additional repairs are considered. Replacement power costs have been incurred in association with this last outage, and could build, depending on the timeline for a solution to be implemented. These and any future costs are not part of Standard & Poor's deferred estimates.

How are these estimated deferrals expected to affect 2005 and 2006 financial performance, especially in the context of the credit benchmarks at the 'BBB-' rating?
Year-end results for 2005 are not yet available, but Standard & Poor's expects that 2005 and 2006 results will be on par with the 12 months ending Sept. 30, 2005, when consolidated adjusted funds from operations (FFO) to total debt was 14.8%. FFO to total debt is an important metric for Standard & Poor's, and at a business profile of '6' (on a 10-point scale where '1' is excellent and '10' vulnerable), it reflects a below-investment-grade performance. For the 12 months ending Sept. 30, 2005, FFO interest coverage was 3.3x, which is reasonable for the current rating. Adjusted total debt to total capitalization was 53.1%, and is solid for the current rating.

Performance in 2007 will be heavily dependent on when the GRC is resolved. APS filed on Nov. 4, 2005, for a $409.1 million (or 19.9%) rate increase, the majority of which is related to fuel and purchased power costs. Typically, the ACC certifies the application as complete within 30 days, and the case commences. But in early December 2005, the ACC requested that the company re-file its application using a test year ending Sept. 30, 2005, rather than the Dec. 31, 2004 data that APS used. The updated application is expected to be re-submitted to the ACC on Jan. 31, 2005.

As a result, the case will not begin until early March 2006, suggesting that an outcome will be delayed roughly three months from the original schedule, which envisions a ruling by early 2007. Recent public statements by the ACC indicate that spring 2007 may be the earliest a decision could be expected. But there is little precedent in Arizona that would suggest a year-long rate case is likely. A more conservative estimate would assume mid-2007. This could be a credit concern because if permanent rate relief is not in place prior to the peak summer season, financial recovery could also be stalled in 2007.

How is the company's liquidity?

Unaudited consolidated cash and investments stood at roughly $150 million as of Dec. 31, 2005. PWCC and APS also maintain a total of $700 million in revolving credit facilities, which had approximately $15 million of usage at year-end 2005 for miscellaneous letters of credit. Standard & Poor's preliminary assessment is that the company's credit lines should be sufficient to support working capital needs, purchases of gas and power, as well as fund margining and collateral requirements for trading operations. As of Dec. 31, 2005, PWCC and APS comfortably met their loan covenant requirements.

PWCC has a $300 million dollar maturity on April 1, which it plans to refinance. Adverse regulatory actions could affect the costs of borrowing or even access to the capital markets, although this is not currently seen as a significant threat.

APS' reliance on purchases and gas-fired peaking capacity during the winter is low; however, this is seasonal. Fuel and purchased power expenses are anticipated to be accrued faster in July 2006 through September 2006. Standard & Poor's is conducting a more detailed liquidity assessment, which will be completed once more clarity is provided on how the ACC is expected to address interim rate relief requests. APS has a significant hedging program and 85% of its 2006 power and gas requirements are hedged. APS and PWCC are currently holding counterparties' collateral as a result of their in-the-money hedged positions.

Could cost saving measures, or the sale of nonregulated assets by PWCC assist in restoring credit quality?

The ACC has requested that the company explain what cost reductions it is making to compensate for the fact that its retail rates are not aligned with production costs. In response, the company cancelled bonuses for its corporate officers, and is certain to investigate additional cost-savings measures. While these actions may address other public policy issues of concern to the ACC, from a credit standpoint cost cutting measures are unlikely to materially alleviate APS' sagging financial performance.

The deferred balances stem from fuel and purchased power costs that the utility incurred to serve retail loads. APS earns no margin on these expenses; they are simply passed straight through to customers. Similar to the circumstances that other western utilities have faced in recent years, APS' fuel and purchased costs substantially exceed the amount currently recoverable in rates. The company may be able to temporarily subsidize the cost of serving retail loads by reducing expenses in other parts of the company, selling other PWCC assets, or issuing debt, but such a strategy is not sustainable, and could very well result in longer-term adverse consequences for the company.

ARIZONA CORPORATION COMMISSION STAFF'S
FOURTH SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-06-0009
FEBRUARY 7, 2006

STF 4.48 Please provide all analysis conducted in preparation for the Emergency Rate Case by the company or its contractors/consultants of the Company's financial condition that have not been previously provided to the Commission.

Response:

See the attachments APS07014 files for financial results assuming the Company received the 14% interim rate increase effective April 1,2006, and attachments APS07015 for financial results assuming the Company received present base rates and no PSA revenues in 2006, but PSA deferrals continued.

Also, see attachment APS07016 file for calculation of the percentage of capital expenditures covered by net cash flow for the past 10 years, as well as the 2006 through 2009 period, that leads to the over $1 billion financing need for 2006-2009.

ARIZONA CORPORATION COMMISSION STAFF'S
FIRST SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
RE: DOCKET NO. E-01345A-06-0009
JANUARY 11, 2006

STF 1-6: At page 5 lines 24-25 Mr. Brandt states that APS' borrowing costs have increased $1 million per year as a result of S& P's downgrade. Please show how that $1 million figure was developed.

Response:

S&P Downgrade Impacts

Increased Annual Costs of Bank Facilities/Insurance:

APS – Sr. Unsecured
Old Rating BBB/Baa1
New Rating BBB-/Baa1

Facility	Amount ($M)	Old Pricing (bp)	New Pricing (bp)	Additional Annual Cost ($)
Citibank Revolver	395.2	9.0	11.0	79,040
Letters of Credit under Revolver	4.8	40.0	50.0	4,800
Sale Leaseback Letter of Credit	93.1	60.0	70.0	46,538
Sale Leaseback Letter of Credit	90.8	60.0	70.0	45,382
Farmington 1994A-C Letter of Credit	149.6	50.0	50.0	0
Coconino 1994A & 1998 Letter of Credit	50.5	60.0	60.0	0
Maricopa 2002A Insurance	90.0	0.0	0.0	0
Coconino 2004A Insurance	12.9	22.5	32.5	12,850
Navajo 2004A-E Insurance	166.2	22.5	32.5	166,150
Maricopa 2005A-E Insurance	164.0	16.0	26.5	172,174
			Total	**$526,934**

Average Commercial Paper Outstanding	$200M
Additional Interest Due to Downgrade	25bp
Additional Annual Interest	**$500K**

The sum of the additional bank facility/insurance costs and the additional interest on commercial paper is $1,026,934.

ARIZONA CORPORATION COMMISSION STAFF'S
FIRST SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
RE: DOCKET NO. E-01345A-06-0009
JANUARY 11, 2006

STF 1-14: Please describe the nature of the "emergency." That is, explain what factor(s) caused APS to characterize their January 6 application as an Application for Emergency Interim Rates ... Please be specific.

Response:

Whether an "emergency" exists is a conclusion to be drawn from the specific facts before the Commission. Indeed the Attorney General stated In Op. Atty. Gen. 71-17 that the "only valid generalization on this subject' [of what constitutes an emergency] is that a mere allegation of a low rate of return, standing alone, is not an "emergency. . ." The Attorney General's opinion further references the need "to avoid serious damage" is the fundamental basis for emergency relief. With this background, the facts are as follows:

(1) APS has experienced a dramatic increase in its fuel and purchased power costs since the establishment of the base fuel rate in Decision No. 67744 and will continue to face continued and significant further increases in those costs during 2006.

(2) Because these increases are not reflected in either base rates or in PSA rates, APS' cost deferrals have reached some $170 million by the end of 2005 and will continue to increase in 2006 even if the annual adjustment to the PSA is implemented on April 1, 2006 and even if the pending PSA surcharge is approved – reaching an estimated $285 million by December 31, 2006.

(3) The continued imbalance between fuel costs and cost recovery has weakened the Company's key financial indicators to the point where APS has been down-rated by one major rating agency (S&P) to the lowest investment-grade rating and put on negative watch for a downgrade by the other two (Moody's and Fitch). All three have threatened further downgrades if the Commission does not address fuel cost recovery in a manner that reverses the downward trend in the Company's financial indicators.

(4) A further downgrade of APS to "junk bond" status will cost between $10-15 million in higher interest and other financing costs in 2006

with an escalating impact in future years such that the total cost increase to customers will be some $1 billion, if not more, over the next 10 years. It will also impede the Company's ability to attract the new capital it will need to meet growth and continue to provide customers with reliable service at a reasonable cost.

(5) Credit limitations imposed on APS as a result of a further downgrading will increase the cost of acquiring the fuel and purchased power needed to serve customers, thus additionally burdening APS customers with costs that could be avoided by timely Commission action to prevent the downgrade. They also consume already scarce cash resources needed to fund infrastructure improvement and expansion. These limitations range from higher collateral requirements, to reduced liquidity as certain venders drop out of the market available to APS, to prepayment requirements for power, gas, gas transportation, and coal.

(6) Once downgraded, it will take years and sustained positive regulatory action to reverse the situation, but the much of the higher cost alluded to above will continue on until such time as the debt incurred during the interim period of years can be repaid or refinanced.

(7) Without an interim raising of the $776.2 million "cap," APS will be unable to defer some $65 million in 2006 fuel costs, thus potentially affecting its ability to ever recover such sums.

(8) The pending APS general rate case will not be decided within a reasonable time, by which the Company means, within time to prevent the above circumstances from happening. And even a 100% favorable outcome from that proceeding likely would not be sufficient to result in an upgrade of APS or undue the loss to APS during 2006 resulting from the $776.2 million "cap."

These facts, if not addressed by the Commission in this interim filing, constitute "serious damage" to APS and its customers just as, if not more so, the inability of APS to timely complete Palo Verde was found to be in 1984 or the prospective loss by Arizona Water Company of tax benefits was found to be in 1982.

On the other hand, APS customers are only being asked to pay for the fuel costs necessary to serve them both since April 2005 and in 2006 – costs for which they will be responsible whether paid in the form of interim rates, PSA charges and/or higher base rates resulting from Docket No. E-01345A-05-0816. To the extent the Commission later finds that any portion of such costs was imprudently incurred, customers will receive a refund or other appropriate adjustment.

In sum, customers are fully protected from a grant of interim relief that is later found to be in even the smallest degree unwarranted by closer examination of the prudence of the Company's actions. Their only protection from the higher costs attributable to the Company's slide into "junk bond" status is action by this Commission. As was again noted by the Attorney General in his opinion, the goal of emergency relief is to prevent the emergency from happening and not to wait until all that can be done is to attempt to repair the damage.

ARIZONA CORPORATION COMMISSION STAFF'S
FOURTH SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-06-0009
FEBRUARY 7, 2006

STF 4.7 Provide a description of all provisions in all APS bond indentures that address minimum financial ratios and/or default conditions

Response:

There are no provisions in any APS' indentures that address minimum financial ratios.

Events of default are:

- Non-payment of principal, interest or fees;
- Non-compliance with covenants;
- Bankruptcy and insolvency events.

See also response to STF 4.8.

ARIZONA CORPORATION COMMISSION STAFF'S
FOURTH SET OF DATA REQUESTS TO
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-06-0009
FEBRUARY 7, 2006

STF 4.8 Provide a description of all provisions in all APS credit arrangements that address minimum financial ratios and/or default conditions

Response:

There are two provisions that address minimum financial ratios. The first one is the requirement that APS maintain Interest Coverage of at least two times, and the second one requires that the amount of debt does not exceed 65% of total capitalization.

Events of default are:

- Non-payment of principal, interest or fees;
- Material misrepresentations;
- Non-compliance with covenants;
- Non-payment under significant operating leases;
- Bankruptcy and insolvency events;
- Judgments against APS significantly exceeding insurance coverage;
- Change in control of PWCC or APS;

ERISA violations.

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744.	DOCKET NO. E-01345A-06-0009

DIRECT

TESTIMONY

OF

J. RANDALL WOOLRIDGE

ON BEHALF OF

THE ARIZONA CORPORATION COMMISSION,

UTILITIES DIVISION STAFF

FEBRUARY 28, 2006

TABLE OF CONTENTS

ATTACHMENTS:

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
EMERGENCY INTERIM RATE INCREASE
DOCKET NO. E-01345A-06-0009

My testimony addresses the following issues:

(1) the impact of the recent bond rating downgrading on APS' financial condition, cost of capital, ability to raise capital, and the Company's customers;

(2) an assessment of whether the downgrade constitutes a financial "Emergency" in the sense that the Company's solvency is in question and/or the Company's ability to maintain service is in serious doubt, and

(3) an evaluation of the likelihood of additional downgrades of APS' debt both with and without the relief requested by APS, and

(4) the impact of such an additional downgrade, if it were to occur, on the Company's cost of capital, ability to raise capital, and the Company's customers.

There are three primary conclusions to my testimony:

(1) The evidence does not indicate that a "financial emergency" exists with respect to APS and the collection of deferred power supply costs. A review of the statements and overall assessments of rating agencies and investment firms do not support such a categorization. In this regard, APS has overstated its current financial condition with reference to the situation in its filing for emergency rate relief. Nonetheless, some improvement on the Company's ability to collect deferred power supply costs through rates would no doubt improve its financial condition.

(2) APS has used the financial ratios used by rating agencies 'as proof' that the Company's bonds may be downgraded to 'junk' status. In this regard, the Company has misconstrued how rating agencies interpret and use these ratios. In short, these ratios do not represent standards that must be met to achieve a particular bond rating.

(3) Based on an analysis of yield spreads, it appears that the S&P downgrading from BBB to BBB- has had a slight increase in the cost of capital for APS.

I. INTRODUCTION

Q. Please state your full name, address, and occupation.

A. My name is J. Randall Woolridge and my business address is 120 Haymaker Circle, State College, PA 16801. I am a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed University Fellow in Business Administration at the University Park Campus of the Pennsylvania State University. I am also the Director of the Smeal College Trading Room and the President of the Nittany Lion Fund, LLC. A summary of my educational background, research, and related business experience is provided in Attachment JRW-1.

II. DISCUSSION OF ISSUES

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to examine a number of issues related to bond ratings of the Company. These issues include (1) the impact of the recent bond rating downgrading on APS' financial condition, cost of capital, ability to raise capital, and the Company's customers; (2) an assessment of whether the downgrade constitutes a financial "Emergency" in the sense that the Company's solvency is in question and/or the Company's ability to maintain service is in serious doubt, and (3) an evaluation of the likelihood of additional downgrades of APS' debt both with and without the relief requested by APS, and (4) the impact of such an additional downgrade, if it were to occur, on the Company's cost of capital, ability to raise capital, and the Company's customers.

Q. Mr. Brandt emphasizes the impact of the recent bond downgrade and the prospect for a further downgrade to 'junk' status.' please discuss the company's bond rating.

A. The Company's current bond ratings are:[1]

[1] See APS response to STF 4.19.

S&P	Moody's	Fitch
BBB-	Baa1	BBB

As shown, the only rating agency that has the Company rated one notch above a 'junk' rating is S&P. Nonetheless, the recent trends in APS' bond ratings have been in a negative direction, and the primary reason given for this negative direction of the ratings is the issue involving the collection of deferred power supply charges.

It is important to recognize that these bond ratings are for the Company's unsecured debt. The table below shows the bond ratings for the Company's mortgage bonds, as taken from Bloomberg. As shown, APS' secured debt is rated BBB by Standard and Poor's.

Arizona Public Services
Outstanding Bonds

Corporate Securities Page 1/1

PNW (9 Found) Cpn Typ All Mty Typ All Exclude Matured/called/MTN

Issuer	Coupon	Maturity	Series	Rtg	Mty Type	Announce	Curr	Ask Px	PCS
1)PINNACLE WST CAP	6.400	04/01/06		BBB-	CALLABLE	03/21/01	USD	100.0000	TRAC
2)ARIZONA PUB SERV	6.750	11/15/06		BBB	CALLABLE	11/19/96	USD	100.9700	TRAC
3)ARIZONA PUB SERV	6.375	10/15/11		BBB	CALLABLE	10/02/01	USD	103.9640	TRAC
4)ARIZONA PUB SERV	6.500	03/01/12		BBB	CALLABLE	02/26/02	USD	103.2210	TRAC
5)ARIZONA PUB SERV	5.800	06/30/14		BBB	CALLABLE	06/24/04	USD	100.9140	TRAC
6)ARIZONA PUB SERV	4.650	05/15/15		BBB	BULLET	05/07/03	USD	93.5180	TRAC
7)PVNGS II FUNDING	8.000	12/30/15		BBB	SINKABLE	03/10/93	USD	110.8181	BFV
8)ARIZONA PUB SERV	5.625	05/15/33		BBB	BULLET	05/07/03	USD	93.4680	TRAC
9)ARIZONA PUB SERV	5.500	09/01/35		BBB	CALLABLE	08/17/05	USD	91.6140	TRAC

Data Source: Bloomberg, February 23, 2006

Q. In your opinion, what is the impact of the recent bond rating downgrade on the Company's financial condition?

A. The downgrading of the Company's bonds certainly is not a positive for the Company. Nonetheless, recent reports from rating agencies and investment firms suggest that recent actions of the Arizona Corporation Commission ("ACC") appear to have stabilized the situation. Specifically, rating agencies and investment firms reacted positively to the January 25th ACC decision to lift the cap on deferred fuel acquisition costs as well as to advance the collection of deferred costs (under the terms of the power supply adjuster ("PSA")). According to a February 2, 2006, report on APS' parent, Pinnacle West Capital Corporation ("PNW"), APS' PSA should provide at least $110M in cash recovery in 2006 of previously incurred fuel costs. In assessing the January 25th decision by ACC, Citigroup indicated that the regulatory risk profile of the Company 'modestly improved.' Likewise, in response to the decision, Standard and Poor's affirmed APS' corporate credit rating of BBB- and termed the decisions 'generally constructive.'

Q. In your opinion does the downgrading of the bonds and the Company's current financial condition constitute an 'emergency' situation?

A. No. Mr. Donald Brandt, the Company's Chief Financial Officer, indicates in his testimony that the current situation facing the Company regarding fuel and purchased power costs constitutes a financial 'emergency.' Based on my review of reports by rating agencies and investment firms, I believe that this overstates the Company's current financial situation.

To illustrate this point, the most recent *Value Line Investment Survey* for PNW, dated February 10, 2006, is attached as Exhibit (JRW-2). In the discussion section of the report, it is noted that PNW has filed for a general rate increase of $409M for 2007. In addition to a summary of the components of the rate request, the report notes the ACC decision of January 25, 2006 to lift the cap on deferred fuel acquisition costs and to advance the collection of deferred costs. There is no mention of, or any indication of, a 'financial emergency' or a 'liquidity crisis.' In fact, Value Line gives PNW its highest 'Safety Rating' – 1 out of 5 – and ranks its 'Financial Strength' an 'A'. Furthermore, with reference to the investment prospects of PNW's stock, *Value Line* makes the following observation: "Those of a conservative bent might also note PNW's strong finances."

A similar observation is made by Standard & Poor's in a stock report on PNW dated February 18, 2006. S&P gives PNW's stock three stars (***), which rates it a 'hold.' More importantly, in S&P's assessment of PNW's peer group of midsized electric utilities, PNW's 'Quality Rating' of 'A-' is the highest of the peer group.[2]

Q. Staff Witness Smith believes that APS has over-stated the direness of its financial situation. Do you agree?

A. Yes. As noted by Mr. Smith, APS has claimed that it is in a "financial crisis" due to the "escalating PSA balances"[3] and "is facing an operational cash flow emergency."[4] These statements are not consistent with the views of rating agencies, investment firms, or APS. The rating agencies have consistently noted that the Company's liquidity position – as indicated by its cash on hand and lines of credit, are 'adequate.' The opinions of investment firms are similar. For example, a Citigroup report on PNW made the following observation:[5]

"We believe that for the near-term undercoveries are manageable through adjustor/surcharge recoveries, cash on hand, and pending equity infusion of over $200M of Silverhawk asset sale proceeds, which closed 1/10/06."

[2] Standard & Poor's Stock Report, Pinnacle West Capital, February 18, 2006. The other electric utilities in the S&P peer group are Duquense Light, Great Plains Energy, Hawaiian Electric Holdings, Pepco Holdings, UIL Holdings, and Westar Energy.
[3] See, e.g., APS Application, page 2, footnote 4.
[4] See, APS application at page 18.
[5] Citigroup, Pinnacle West Capital Corporation, February 2, 2006, p. 3.

Even APS appears not to believe that the 'financial crisis' story that it once proclaimed. In response to Commissioner Mayes, the Company's President Mr. Davis makes the following comment:

> And the credit rating agencies have not expressed concern over APS' current liquidity situation. As a matter of fact, APS currently has cash on hand of about $80 million. But again, current liquidity is not the issue at hand.

Q. APS points to the financial ratios used by rating agencies as evidence that a financial emergency exists. Please respond.

A. Mr. Brandt not only suggests that the Company's situation constitutes a financial emergency, he also indicates that if the Commission does not provide the emergency rate relief proposed by the Company that APS' credit ratings would likely be downgraded by rating agencies to below investment grade even with the approval of the PSA surcharge and the implementation of the annual PSA adjustment. He supports his argument by reference to the financial ratios used by the rating agencies. Likewise, in response to Commissioner Mayes, APS President Mr. Davis references the financial ratios to support the case for emergency relief:

> The continuing imbalance between fuel costs and cost recovery has weakened the Company's key credit strength indicator (the ratio of Funds from Operations to Debt, known as FFO Debt) to the point where APS has been downgraded by one major rating agency (S&P) to the lowest investment-grade rating and put on negative watch for a downgrade by the other two (Moody's and Fitch).

Q. Given these arguments by APS, please discuss the role of financial ratios in the ratings process.

A. The rating agencies consider many factors in their ratings process. These factors include many business risk indicators such as the economic conditions of the service territory, competitive environment, regulatory climate, customers, and exposure to unregulated businesses. Ratio analysis is also part of the credit risk analysis performed by rating agencies. Rating agencies do publish guidelines for key financial ratios. Standard and Poor's lists guidelines for three ratios: Funds from Operations/Interest ("FFO/INT"), Funds from Operations/Total Debt ("FFO/TD"), and Total Debt/Total Capital ("TD/TC").

Initially, it is important to highlight the fact that the ratios published by rating agencies for different bond ratings are not strict standards which must be met to achieve a particular bond rating. For example, with reference to the three ratios listed above, S&P states:[6]

> It is important to emphasize that these metrics are only guidelines associated with expectations for various rating levels. Although credit ratio analysis is an important part of the rating process, these three statistics are by no means the only critical financial measures that Standard & Poor's uses in its analytical process. We also analyze a wide array of financial ratios that do not have published guidelines for each rating category.

And S&P goes on to further emphasize this point:

> Again, ratings analysis is not driven solely by these financial ratios, nor has it ever been. In fact, the new financial guidelines that Standard & Poor's is incorporating for the specified rating categories reinforce the analytical framework whereby other factors can outweigh the achievement of otherwise acceptable financial ratios. These factors include:
>
> Effectiveness of liability and liquidity management;
> Analysis of internal funding sources;
> Return on invested capital;
> The record of execution of stated business strategies;
> Accuracy of projected performance versus actual results, as well as the trend;
> Assessment of management's financial policies and attitude toward credit; and

[6] Standard & Poor's, "New Business Profile Scores Assigned for U.S. Utility and Power Companies: Financial Guidelines revised," June 2, 2004, p. 3.

Corporate governance practices."

Furthermore, S&P has warned against using ratios to conclude appropriate bond ratings:[7]

> The key ratio medians for U.S. corporations by rating category and their definitions are displayed below. The ratio medians are purely statistical, and are not intended as a guide to achieving a given rating level. They are not hurdles or prerequisites that should be achieved to attain a specific debt rating.

Moody's appears to be even more qualitative in their rating approach. Moody's explains their approach in the following fashion:[8]

> Because it involves a look into the future, credit rating is by nature subjective. Moreover, because long-term credit judgments involve so many factors unique to particular industries, issuers, and countries, we believe that any attempt to reduce credit rating to a formulaic methodology would be misleading and would lead to serious mistakes.
>
> That is why Moody's uses a multidisciplinary or "universal" approach to risk analysis, which aims to bring an understanding of *all* relevant risk factors and viewpoints to every rating analysis. We then rely on the judgment of a diverse group of credit risk professionals to weigh those factors in light of a variety of plausible scenarios for the issuer and thus come to a conclusion on what the rating should be.

Q. What other observations do you have on the use of financial ratios in credit analysis?

A. Not only are the ratios not strict standards to meet different rating categories, these guidelines have broad ranges. The table below shows the ranges for the three ratios for a BBB rating and a business profile of 6.[9]

---

7 Standard & Poor's, " Corporate Ratings Criteria," June 9, 2005, p. 42.
8
http://www.moodys.com/moodys/cust/AboutMoodys/AboutMoodys.aspx?%20topic=rapproach
9 Standard & Poor's, "New Business Profile Scores Assigned for U.S. Utility and Power Companies: Financial Guidelines Revised," June 2, 2004.

S&P Ratio Ranges
BBB Rating – Business Profile of 6

Ratio	High	Low
FFO/INT	4.2	3.0
FFO/TD	28%	15%
TD/TC	48%	58%

Furthermore, Moody's financial ratio guidelines for Baa rated utilities are even broader than those published by S&P, as shown below: profile of 3.[10]

Moody's Ratio Ranges
Baa Rating – Low Business Risk

Ratio	High	Low
FFO/INT	4.0	2.0
FFO/TD	13%	5%
TD/TC	75%	60%

Q. Given this discussion, what are APS' FFO/INT, FFO/TD, and TD/TC ratios?

A. Whereas Mr. Brandt and Mr. Davis emphasize the FFO/TD ratio, S&P does publish guidelines on all three ratios discussed above. For APS, these ratios as of 2005 are:[11]

Arizona Public Service
2005

Ratio	2005
FFO/INT	3.3
FFO/TD	14.8%
TD/TC	50.1%

As shown, the only ratio that violates S&P's guidelines for the BBB rating is FFO/TD. The other ratios fall within the range specified by S&P for a BBB rating.

[10] Moody's Rating Methodology: Global Regulated Electric Utilities, March 2005, page 9.
[11] As computed by APS in Attachment APS07015. Calculation presumes present rates PSA deferrals, but no PSA increase.

Q. Do you believe that the bond downgrading has restricted the Company's access to capital?

A. No. And the Company has presented no evidence that the downgrading has restricted the Company's access to capital.

Q. If the Company were to be downgraded to 'junk' status, do you believe that such an event would restrict the Company's access to capital?

A. Yes, I do believe that such an event would restrict the Company's access to capital.

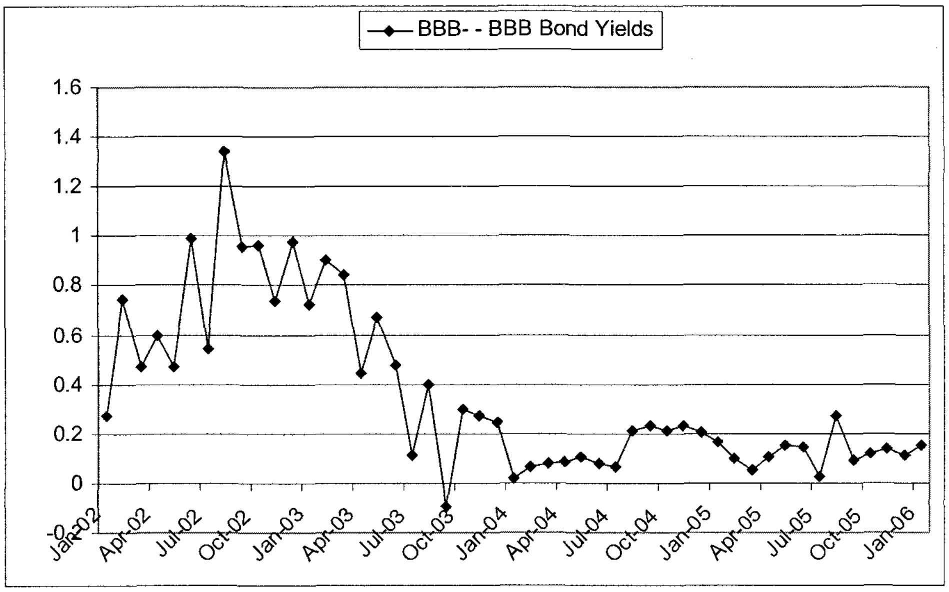
Q. Has the Company presented any evidence that its bonds are about to be downgraded to 'junk' status?

A. No, and as discussed by Staff witness Smith, the rating status of the bonds by S&P, the only agency that has the Company's bond rating one notch above 'junk' status, is stable.

Q. Finally, please comment on the impact of the S&P downgrading on the Company's cost of capital.

A. The downgrading of the Company's bonds to BBB- by S&P has had a slight increase in the Company's overall cost of capital. The graph below shows the yield differential between long-term public utility bonds rated 'BBB' and 'BBB-.' The graph shows that as of January, 2006, was 15 basis points.

Yield Differential
Long-Term Public Utility Bonds
BBB- - BBB Yields



Data Source: Bloomberg

III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. Please summarize your findings and recommendations.

A. There are three primary conclusions to my testimony:

(1) The evidence does not indicate that a "financial emergency" exists with respect to APS and the collection of deferred power supply costs. A review of the statements and overall assessments of rating agencies and investment firms do not support such a categorization. In this regard, APS has overstated its current financial condition with reference to the situation in its filing for emergency rate relief. Nonetheless, some improvement on the Company's ability to collect deferred power supply costs through rates would no doubt improve its financial condition.

(2) APS has used the financial ratios used by rating agencies 'as proof' that the Company's bonds may be downgraded to 'junk' status. In this regard, the Company has misconstrued

how rating agencies interpret and use these ratios. In short, these ratios do not represent standards that must be met to achieve a particular bond rating.

(3) Based on an analysis of yield spreads, it appears that the S&P downgrading from BBB to BBB- has had a slight increase in the cost of capital for APS.

Q. Does this conclude your testimony?

A. Yes it does.

APPENDIX A

EDUCATIONAL BACKGROUND, RESEARCH, AND RELATED BUSINESS EXPERIENCE J. RANDALL WOOLRIDGE

J. Randall Woolridge is a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed Faculty Fellow in Business Administration in the College of Business Administration of the Pennsylvania State University in University Park, PA. In addition, Professor Woolridge is Director of the Smeal College Trading Room and President and CEO of the Nittany Lion Fund, LLC. He is also a Vice President of the Columbia Group, a public utility consulting firm based in Georgetown, CT, and serves on the Investment Committee of ARIS Corporation, an asset management firm based in State College, PA.

Professor Woolridge received a Bachelor of Arts degree in Economics from the University of North Carolina, a Master of Business Administration degree from the Pennsylvania State University, and a Doctor of Philosophy degree in Business Administration (major area-finance, minor area-statistics) from the University of Iowa. At Iowa he received a Graduate Fellowship and was awarded membership in Beta Gamma Sigma, a national business honorary society. He has taught Finance courses at the University of Iowa, Cornell College, and the University of Pittsburgh, as well as the Pennsylvania State University. These courses include corporation finance, commercial and investment banking, and investments at the undergraduate, graduate, and executive MBA levels.

Professor Woolridge's research has centered on the theoretical and empirical foundations of corporation finance and financial markets and institutions. He has published over 25 articles in the best academic and professional journals in the field, including the *Journal of Finance,* the *Journal of Financial Economics,* and the *Harvard Business Review.* His research has been cited extensively in the business press. His work has been featured in the *New York Times*, *Forbes, Fortune, The Economist*, *Financial World*, *Barron's*, *Wall Street Journal*, *Business Week*, *Washington Post*, *Investors' Business Daily*, *Worth Magazine*, *USA Today*, and other publications. In addition, Dr. Woolridge has appeared as a guest on CNN's *Money Line* and CNBC's *Morning Call* and *Business Today*.

The second edition of Professor Woolridge's popular stock valuation book, *The StreetSmart Guide to Valuing a Stock* (McGraw-Hill, 2003), was recently released. He has also co-authored *Spinoffs and Equity Carve-Outs: Achieving Faster Growth and Better Performance* (Financial Executives Research Foundation, 1999) as well as a new textbook entitled *Modern Corporate Finance, Capital Markets, and Valuation* (Kendall Hunt, 2003). Dr. Woolridge is a founder and a managing director of www.valuepro.net - a stock valuation website.

Professor Woolridge has also consulted with and prepared research reports for major corporations, financial institutions, and investment banking firms, and government agencies. In addition, he has directed and participated in over 500 university- and company- sponsored professional development programs for executives in 25 countries in North and South America, Europe, Asia, and Africa.

Dr. Woolridge has prepared testimony and/or provided consultation services in the following cases:

Pennsylvania: Dr. Woolridge has prepared testimony on behalf of the Pennsylvania Office of Consumer Advocate in the following cases before the Pennsylvania Public Utility Commission:
Bell Telephone Company (R-811819), Peoples Natural Gas Company (R-832315), Pennsylvania Power Company (R-832409), Western Pennsylvania Water Company (R-832381), Pennsylvania Power Company (R-842740), Pennsylvania Gas and Water Company (R-850178), Metropolitan Edison Company (R-860384), Pennsylvania Electric Company (R-860413), North Penn Gas Company (R-860535), Philadelphia Electric Company (R-870629), Western Pennsylvania Water Company (R-870825), York Water Company (R-870749), Pennsylvania-American Water Company (R-880916), Equitable Gas Company (R-880971), the Bloomsburg Water Co. (R-891494), Columbia Gas of Pennsylvania, Inc. (R-891468), Pennsylvania-American Water Company (R-90562), Breezewood Telephone Company (R-901666), York Water Company (R-901813), Columbia Gas of Pennsylvania, Inc. (R-901873), National Fuel Electric

utility Company (R-911912), Pennsylvania-American Water Company (R-911909), Borough of Media Water Fund (R-912150), UGI Utilities, Inc. - Electric Utility Division (R-922195), Dauphin Consolidated Water Supply Company - General Waterworks of Pennsylvania, Inc, (R-932604), National Fuel Electric utility Company (R-932548), Commonwealth Telephone Company (I-920020), Conestoga Telephone and Telegraph Company (I-920015), Peoples Natural Gas Company (R-932866), Blue Mountain Consolidated Water Company (R-932873), National Fuel Gas Company (R-942991), UGI - Gas Division (R-953297), UGI - Electric Division (R-953534), Pennsylvania-American Water Company (R-973944), Pennsylvania-American Water Company (R-994638), Philadelphia Suburban Water Company (R-994868;R-994877;R-994878; R-9948790), Philadelphia Suburban Water Company (R-994868), Wellsboro Electric Company (R-00016356), Philadelphia Suburban Water Company (R-00016750), National Fuel Electric utility Company (R-00038168), Pennsylvania-American Water Company (R-00038304), York Water Company (R-00049165), Valley Energy Company (R-00049345), Wellsboro Electric Company (R-00049313), and National Fuel Electric utility Corporation (R-00049656).

New Jersey: Dr. Woolridge prepared testimony for the New Jersey Department of the Public Advocate, Division of Rate Counsel: New Jersey-American Water Company (R-91081399J), New Jersey-American Water Company (R-92090908J), and Environmental Disposal Corp (R-94070319).

Hawaii: Dr. Woolridge prepared testimony for the Hawaii Office of the Consumer Advocate: East Honolulu Community Services, Inc. (Docket No. 7718).

Delaware: Dr. Woolridge prepared testimony for the Delaware Division of Public Advocate: Artesian Water Company (R-00-649).

Ohio: Dr. Woolridge prepared testimony for the Ohio Office of Consumers' Council: SBC Ohio (Case No. 02-1280-TP-UNC R-00-649).

New York: Dr. Woolridge prepared testimony for the County of Nassau in New York State: Long Island Lighting Company (PSC Case No. 942354).

Connecticut: Dr. Woolridge prepared testimony for the Office of Consumer Counsel in Connecticut: United Illuminating (Docket No. 96-03-29) and Yankee Gas Company (Docket No. 04-06-01).

Kentucky: Dr. Woolridge prepared testimony for the Office of Attorney General in Kentucky: Kentucky-American Water Company (Case No. 2004-00103).

Washington, D.C.: Dr. Woolridge prepared testimony for the Office of the People's Counsel in the District of Columbia: Potomac Electric Power Company (Formal Case No. 939).

Washington: Dr. Woolridge consulted with trial staff of the Washington Utilities and Transportation Commission on the following cases: Puget Energy Corp. (Docket Nos. UE-011570 and UG-011571); and Avista Corporation (Docket No. UE-011514).

Kansas: Dr. Woolridge prepared testimony on behalf of the Kansas Citizens' Utility Ratepayer Board Utilities in the following cases: Western Resources Inc. (Docket No. 01-WSRE-949-GIE) and UtiliCorp (Docket No. 02-UTCG701-CIG).

FERC: Dr. Woolridge has prepared testimony on behalf of the Pennsylvania Office of Consumer Advocate in the following cases before the Federal Energy Regulatory Commission: National Fuel Gas Supply Corporation (RP-92-73-000) and Columbia Gulf Transmission Company (RP97-52-000).

Vermont: Dr. Woolridge prepared testimony for the Department of Public Service in the Central Vermont Public Service Case (Docket No. 6988).

1

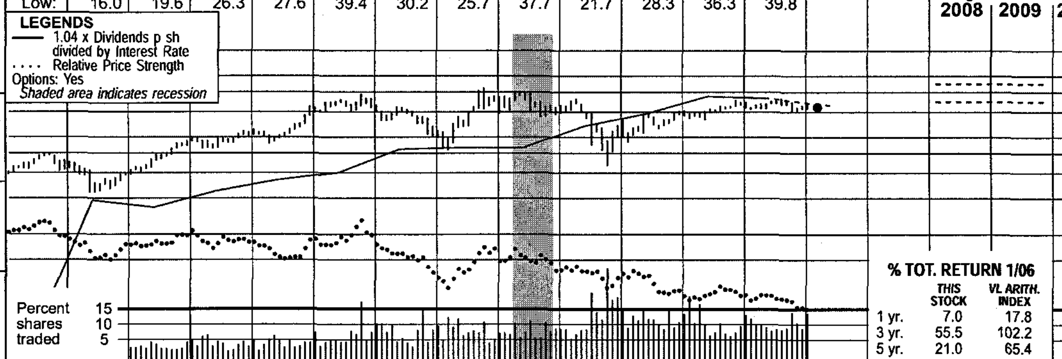
PINNACLE WEST NYSE-PNW

RECENT PRICE	P/E RATIO	RELATIVE P/E RATIO	DIV'D YLD	
42.33	12.6 (Trailing: 12.9 Median: 12.0)	0.65	4.8%	VALUE LINE

TIMELINESS **3** Raised 8/5/05
SAFETY **1** Raised 5/16/03
TECHNICAL **4** Lowered 2/3/06
BETA .90 (1.00 = Market)

High:	22.8	28.9	32.3	42.8	49.3	43.4	52.7	50.7	46.7	40.5	45.8	46.7
Low:	16.0	19.6	26.3	27.6	39.4	30.2	25.7	37.7	21.7	28.3	36.3	39.8

Target Price Range 2008 | 2009 | 2010



2008-10 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	55	(+30%)	10%
Low	45	(-5%)	6%

Insider Decisions

	M	A	M	J	J	A	S	O	N
to Buy	0	0	0	0	0	0	0	0	0
Options	0	0	0	0	1	8	0	0	0
to Sell	0	0	0	0	1	8	0	0	0

Institutional Decisions

	1Q2005	2Q2005	3Q2005
to Buy	129	162	147
to Sell	90	76	106
Hld's(000)	67222	71481	72697

% TOT. RETURN 1/06

	THIS STOCK	VL ARITH. INDEX
1 yr.	7.0	17.8
3 yr.	55.5	102.2
5 yr.	21.0	65.4

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	© VALUE LINE PUB., INC.	08-10
17.39	18.38	16.95	19.39	19.66	19.28	19.08	20.77	23.52	25.12	28.57	43.50	53.66	28.90	30.87	31.59	30.15	32.50	Revenues per sh	36.00
3.45	3.27	d1.39	4.70	5.25	5.09	5.16	5.90	7.12	7.34	7.73	7.99	8.72	7.01	7.33	6.93	7.60	8.10	"Cash Flow" per sh	9.60
1.44	.81	d3.90	1.73	1.95	1.99	2.22	2.47	2.76	2.85	3.18	3.35	3.68	2.53	2.52	2.58	3.26	3.25	Earnings per sh A	3.55
.80	--	--	--	.20	.83	.93	1.03	1.13	1.23	1.33	1.43	1.53	1.63	1.73	1.83	1.93	2.03	Div'd Decl'd per sh B■†	2.33
3.46	2.98	2.10	2.57	2.69	2.92	3.38	2.95	3.63	3.76	4.05	7.76	12.27	9.81	7.60	5.86	9.35	8.90	Cap'l Spending per sh	8.05
16.31	17.40	15.23	17.00	18.87	20.32	21.49	22.51	23.90	25.50	26.00	28.09	29.46	29.44	31.00	32.14	33.65	34.90	Book Value per sh C	38.75
86.72	86.87	87.01	87.16	87.42	87.43	87.52	87.52	84.83	84.83	84.83	84.83	84.83	91.26	91.29	91.79	99.10	99.10	Common Shs Outst'g D	99.10
8.7	16.3	--	10.8	11.5	9.6	10.8	11.8	11.8	15.2	11.9	11.3	12.0	14.4	14.0	15.8	13.2		Avg Ann'l P/E Ratio	14.5
.66	1.21	--	.66	.68	.63	.72	.74	.68	.79	.68	.73	.61	.79	.80	.84	.70		Relative P/E Ratio	.95
6.4%	--	--	--	.9%	4.3%	3.9%	3.5%	3.5%	2.8%	3.5%	3.8%	3.5%	4.5%	4.9%	4.5%	4.5%		Avg Ann'l Div'd Yield	5.2%

CAPITAL STRUCTURE as of 9/30/05
Total Debt $2811.6 mill. **Due in 5 Yrs** $1439.4 mill.
LT Debt $2569.4 mill. **LT Interest** $153.0 mill.
(LT interest earned: 4.2x)

Pension Assets-12/04 $982.3 mill. **Oblig.** $1.45 bill.

Pfd Stock None

Common Stock 99,000,520 shs. **as of 11/7/05**
MARKET CAP: $4.1 billion (Mid Cap)

1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006		08-10
1669.8	1817.8	1995.0	2130.6	2423.4	3690.2	4551.4	2637.3	2817.9	2899.7	2988.0	3220	Revenues ($mill) F	3570
194.4	198.3	248.7	252.6	270.8	283.6	312.2	215.2	230.6	235.2	314.9	320	Net Profit ($mill)	350
39.7%	39.3%	37.7%	39.5%	38.3%	44.1%	40.6%	39.1%	31.4%	35.4%	35.0%	35.0%	Income Tax Rate	35.0%
7.2%	7.4%	6.5%	7.4%	4.3%	7.6%	15.3%	20.5%	6.2%	6.9%	2.0%	2.0%	AFUDC % to Net Profit	2.0%
53.9%	52.0%	50.5%	47.6%	50.0%	45.1%	51.7%	51.8%	50.6%	46.7%	44.0%	44.5%	Long-Term Debt Ratio	47.0%
40.4%	43.2%	45.6%	50.2%	50.0%	54.9%	48.3%	48.2%	49.4%	53.3%	56.0%	55.5%	Common Equity Ratio	53.0%
4660.4	4561.1	4442.9	4307.6	4411.8	4337.8	5172.4	5567.9	5727.5	5535.2	5935	6260	Total Capital ($mill)	7240
4647.1	4655.1	4677.6	4730.6	4778.5	5133.2	5907.3	6479.4	7480.1	7535.5	8025	8425	Net Plant ($mill)	9260
6.4%	6.2%	7.4%	7.6%	7.9%	8.1%	7.6%	5.4%	5.5%	5.6%	6.5%	6.5%	Return on Total Cap'l	6.5%
9.0%	9.1%	11.3%	11.2%	12.3%	11.9%	12.5%	8.0%	8.1%	8.0%	9.5%	9.5%	Return on Shr. Equity	9.0%
9.3%	9.2%	11.6%	11.2%	12.2%	11.9%	12.5%	8.0%	8.1%	8.0%	9.5%	9.5%	Return on Com Equity E	9.0%
5.0%	4.6%	6.9%	6.4%	7.1%	6.8%	7.3%	2.9%	2.6%	2.3%	4.0%	3.5%	Retained to Com Eq	3.0%
51%	54%	44%	45%	42%	43%	41%	64%	68%	71%	59%	62%	All Div'ds to Net Prof	66%

ELECTRIC OPERATING STATISTICS

	2002	2003	2004
% Change Retail Sales (KWH)	-.2	+5.1	+3.2
Avg. Indust. Use (MWH)	660	695	707
Avg. Indust. Revs. per KWH (¢)	5.57	5.62	5.57
Capacity at Peak (Mw)	6490	7935	7758
Peak Load, Summer (Mw)	5803	6332	6402
Annual Load Factor (%)	52.6	50.9	52.2
% Change Customers (yr-end)	+3.1	+3.3	+3.7
Fixed Charge Cov. (%)	274	250	261

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '02-'04 to '08-'10
Revenues	4.5%	3.5%	3.0%
"Cash Flow"	3.5%	-1.0%	5.0%
Earnings	3.0%	-3.0%	6.0%
Dividends	17.5%	7.0%	5.0%
Book Value	5.0%	4.0%	4.0%

Cal-endar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2002	501.5	618.4	873.0	644.4	2637.3
2003	552.7	683.3	847.7	734.2	2817.9
2004	566.3	711.9	886.8	734.7	2899.7
2005	615.1	755.8	955.6	691.6	2988.0
2006	645	785	985	805	3220

Cal-endar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2002	.63	.89	1.19	d.18	2.53
2003	.22	.60	1.20	.50	2.52
2004	.34	.78	1.14	.32	2.58
2005	.27	.87	1.89	.23	3.26
2006	.35	.90	1.75	.25	3.25

Cal-endar	QUARTERLY DIVIDENDS PAID B■† Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2002	.40	.40	.40	.425	1.63
2003	.425	.425	.425	.45	1.73
2004	.45	.45	.45	.475	1.83
2005	.475	.475	.475	.50	1.93
2006					

BUSINESS: Pinnacle West Capital Corporation (parent of Arizona Public Service) supplies electricity to approx. 1,780,000 people in 11 of 15 Arizona counties. Electric revenue sources: residential, 50%; commercial, industrial, and other, 50%. Power costs: 38% of electric revenues; labor costs: 13% of total revenues. The mining industry is the largest industrial customer. Energy sources: coal, 21%; nuclear, 14%; gas & other, 8%; purch. power, 57%. Has 7,200 employees; 34,248 stockholders. Reported '04 depreciation rate: 3.4%. Est'd plant age: 8 years. Chairman & CEO: William J. Post. Pres.: Jack E. Davis. Inc.: Arizona. Address: 400 E. Van Buren St., Suite 700, P.O. Box 52132, Phoenix, AZ 85072-2132. Tel.: 602-379-2568. Internet: www.pinnaclewest.com.

Pinnacle West has filed its general rate case for 2007. It seeks an increase of $409 million, based on an 11.50% allowed return on common equity, up from the current 10.25%. About $247 million, or 60% of the total, is for recovery of the high cost of fuel and purchased power. The application also asks for a $42.5 million boost in the rate base for the May, 2005 purchase of the 450-megawatt gas-fired Sundance plant. Another $41.2 million is sought to defray rising pension expenses. Management plans to accelerate the funding of this underfunded account over five years. Lastly, the proposal calls for timely cost recovery of environmental upgrades through a $4.4 million surcharge to annual rates. A regulatory order on the petition is due by yearend. Separately, the commission modified the power supply adjustor that limited fuel cost recovery above an annual $776.2 million cap. This will allow recoupment of $112 million of deferred costs over the next 12 months.

The company has sold its Silverhawk gas-fired plant. This 75%-owned, 570-megawatt unit was Pinnacle's only merchant facility. Because of a difficult wholesale market, the plant was never profitable. Though the company provides no breakdown, we think the plant's operation resulted in a loss between $0.20 and $0.25 a share last year. As a result, the unit was sold in early 2006 to Nevada Power for $208 million. PNW booked a $55 million aftertax loss on the sale, which we've excluded from our estimates because of its nonrecurring nature.

We look for only flat earnings in 2006. Retail energy sales will probably rise by 4%-5% again this year. But the gain will be offset by increased operating and maintenance expense related to customer service and benefit costs. For now, we estimate 2006 earnings of $3.25 a share. If the regulators authorize a reasonable increase on the aforementioned rate request, earnings would move substantially higher in 2007.

Dividend growth prospects exceed those of the group. Projected earnings gains after 2006 and a low payout ratio point to above-average dividend growth to 2008-2010. Those of a conservative bent might also note PNW's strong finances.

Arthur H. Medalie — *February 10, 2006*

(A) Diluted egs. Excl. nonrecur.: '91, ($4.68); '93, 22¢; '94, 31¢; '95, net 6¢; '99, ($1.20); '02, (77¢); excl. discont.: '89, ($7.80); '90, 31¢; '91, $1.76; '92, 7¢; '99, ($1.97); '00, 22¢; '05, (36¢). Next egs. rpt. due late Apr. (B) Div'ds historically paid in early Mar., early June, early Sept., and early Dec. ■ Reinvest. plan avail. † Shareholder investment plan avail. (C) Incl. def. chgs. In '04: $2.64/sh. (D) In mill. (E) Rate base: Fair value. Rate all'd on com. eq. in '05: 10.25%; earn. on avg. com. eq. in '04: 8.1%. Regul. Clim.: Avg.

Company's Financial Strength	A
Stock's Price Stability	80
Price Growth Persistence	55
Earnings Predictability	65

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744.)	DOCKET NO. E-01345A-06-0009

DIRECT

TESTIMONY

OF

BARBARA KEENE

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

FEBRUARY 28, 2006

TABLE OF CONTENTS

Page

APPENDICES

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
EMERGENCY INTERIM RATE INCREASE
DOCKET NO. E-01345A-06-0009

This testimony estimates the impact of Arizona Public Service Company's proposed emergency interim rate increase on the bills of its residential customers. The testimony also responds to the February 9, 2006, letter by Commissioner Mayes for estimates of the impact on bills of the rate increase approved in April 2005; the February 1, 2006, adjustor reset; APS' proposed surcharges; and the proposed general 2006 rate case.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Barbara Keene. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Utilities Division of the Arizona Corporation Commission as a Public Utilities Analyst Manager. My duties include supervising the energy portion of the Telecommunications and Energy Section. A copy of my résumé is provided in Appendix 1.

Q. As part of your employment responsibilities, were you assigned to review matters contained in Docket No. E-01345A-06-0009?

A. Yes.

Q. What is the subject matter of your testimony?

A. Staff's testimony estimates the impact of Arizona Public Service Company's ("APS") proposed emergency interim rate increase on the bills of its residential customers. The testimony also responds to the February 9, 2006, letter by Commissioner Mayes for estimates of the impact on bills of the rate increase approved in April 2005; the February 1, 2006, adjustor reset; APS' proposed surcharges; and the proposed general 2006 rate case.

IMPACT OF APS' PROPOSED EMERGENCY INTERIM RATE INCREASE

Q. What did APS propose in its application for an emergency interim rate increase?

A. In its application, APS proposed that the base cost of fuel and purchased power be reset to \$0.031904 per kWh. In April 2005, Decision No. 67744 set the base cost at \$0.020743 per kWh. Therefore, the difference between the two base costs would be \$0.011161 per kWh.

Q. What is the effect of changing the base cost?

A. There are actually two effects of APS' proposal. The first effect is that customer rates would go up by \$0.011161 per kWh. The second effect is that future amounts being deferred for recovery through APS' Power Supply Adjustor ("PSA") would be reduced because of the higher base cost of fuel and purchased power.

Impact on Customer Bills of APS' Proposal

Q. What would be the impact on customer bills of APS' proposed emergency interim rate increase?

A. As proposed by APS, rates would be increased by \$0.011161 per kWh. Although APS requested the increase to be effective on April 1, 2006, the current procedural schedule contemplates a Commission Decision in May 2006. As a result of the increase, the average summer bill for a residential customer on E-12 (using 1,047 kWh) would increase by \$11.69 or 9.97 percent over current rates.

Table 1
Impact of APS-Proposed Emergency Interim Rate Increase on Residential Customer Bills

	E-12 Bill Under Current Rates	E-12 Bill With Emergency Interim Rate Increase	Dollar Increase	Percent Increase
Summer (July)				
Average Usage (1047 kWh)	$117.26	$128.94	$11.69	9.97%
Median Usage (818 kWh)	$87.66	$96.79	$9.13	10.41%
Winter (December)				
Average Usage (677 kWh)	$61.80	$69.35	$7.56	12.23%
Median Usage (531 kWh)	$50.26	$56.19	$5.93	11.79%

Impact on the PSA of APS' Proposal

Q. Please describe the impact of APS' proposed emergency interim rate increase on the PSA.

A. APS' proposal would raise the base cost of fuel and purchased power from $0.020743 per kWh to $0.031904 per kWh. In the PSA Tracking Account, actual costs are compared to base costs. The annual adjustor rate calculation uses the difference between the actual costs and the base costs in the determination of the new adjustor rate. If base costs are closer to actual costs, the amount flowing into the adjustor rate calculation is smaller.

Using APS' forecasts of sales and fuel and purchased power costs for 2006, the Tracking Account balance at the end of the year would be about [redacted] if the base cost remains at $0.020743 per kWh. The February 2007 adjustor rate calculation would result in the Adjustor Rate [redacted] and about [redacted] going into the Paragraph 19(d) Balancing Account. This calculation assumes that no surcharges to collect 2005 costs were approved. (See Appendix 2 for the PSA schedules.)

If the base cost is raised to $0.031904 per kWh in May 2006, the Tracking Account balance at the end of the year would be about [redacted]. The February 2007 adjustor rate calculation would result in the Adjustor Rate [redacted] and [redacted] going into the Paragraph 19(d) Balancing Account.

BILL IMPACTS OF OTHER RATE INCREASES

Q. Please describe the impacts on customer bills of other approved or proposed rate increases, as requested by the February 9, 2006, letter of Commissioner Mayes.

A. The first rate increase to be discussed is the rate case increase approved by the Commission in April 2005 (Decision No. 67744). Before that rate increase, the average summer bill for a residential customer on E-12 (using 1,047 kWh in July) was $108.10. After the rate increase, the bill increased by $4.97 or 4.60 percent. The average winter bill for a residential customer on E-12 (using 677 kWh in December) was $57.91 before the rate increase. After the rate increase, the bill increased by $1.18 or 2.04 percent.

Table 3
Impact of April 2005 Rate Case Decision on Residential Customer Bills

	E-12 Bill Before 4/05 Rate Case Increase	E-12 Bill After 4/05 Rate Case Increase	Dollar Increase	Percent Increase
Summer (July)				
Average Usage (1,047 kWh)	$108.10	$113.07	$4.97	4.60%
Median Usage (818 kWh)	$80.64	$84.39	$3.75	4.65%
Winter (December)				
Average Usage (677 kWh)	$57.91	$59.09	$1.18	2.04%
Median Usage (531 kWh)	$47.11	$48.14	$1.03	2.19%

Q. As other rate impacts are discussed, how will the impact over time be described?

A. For each rate change, the impact on the rates current at that time will be discussed and the cumulative impact of all the rate changes that had occurred by that time will be described. The cumulative rate impacts represent the change from rates that were in effect before the April 2005 rate case decision and are listed under the heading "Cumulative Percent Increase Over pre-April 05 Rates" in the tables.

Q. Can the individual rate percent increases be added together to total a cumulative percent increase?

A. No. The rate impacts are compounded. Here is an example.

step 1. A customer bill is $10.

step 2. A 5 percent increase makes the bill $10.50 (5 % of $10 = $0.50).

step 3. Then a 4 percent increase makes the bill $10.92 (4% of $10.50 = $0.42).

step 4. Compare the bill in step 3 ($10.92) to the bill in step 1 ($10): $10.92 is 9.2 percent higher than $10. This is different than simply adding 5 percent and 4 percent to total 9 percent. It is because the 4 percent is applied to $10.50, not to $10.

Q. Please describe the next rate impact on APS' residential customers.

A. The next rate impact was the resetting of the PSA adjustor rate on February 1, 2006. The PSA was increased by $0.004 per kWh. As a result, the average winter bill for a residential customer on E-12 (using 677 kWh) increased by $2.71 or 4.58 percent. The cumulative percent increase including the April 2005 rate case decision was 6.71 percent for winter bills and 8.47 percent for summer bills.

Table 4
Impact of February 2006 PSA Adjustor Rate Reset on Residential Customer Bills

	E-12 Bill After 4/05 Rate Case Increase	E-12 Bill After 2/06 PSA Adjustor Rate Reset	Dollar Increase	Percent Increase	Cumulative Percent Increase Over pre-April 05 Rates
Summer (July)					
Average Usage (1047 kWh)	$113.07	$117.26	$4.19	3.70%	8.47%
Median Usage (818 kWh)	$84.39	$87.66	$3.27	3.88%	8.71%
Winter (December)					
Average Usage (677 kWh)	$59.09	$61.80	$2.71	4.58%	6.71%
Median Usage (531 kWh)	$48.14	$50.26	$2.12	4.41%	6.69%

Q. Please describe the rate impact associated with APS' proposed emergency interim rate request.

A. As proposed by APS, rates would be increased by $0.011161 per kWh. As a result of the increase, the average summer bill for a residential customer on E-12 (using 1,047 kWh) would increase by $11.69 or 9.97 percent. The cumulative percent increase, including the April 2005 rate case decision and the resetting of the PSA adjustor rate, would be 19.28 percent for summer bills and 19.76 percent for winter bills.

Table 5
Impact of APS-Proposed May 2006 Emergency Interim Rate Increase on Residential Customer Bills

	E-12 Bill After 2/06 PSA Adjustor Rate Reset	E-12 Bill After 5/06 Emergency Interim Rate Increase	Dollar Increase	Percent Increase	Cumulative Percent Increase Over pre-April 05 Rates
Summer (July)					
Average Usage (1047 kWh)	$117.26	$128.94	$11.69	9.97%	19.28%
Median Usage (818 kWh)	$87.66	$96.79	$9.13	10.41%	20.03%
Winter (December)					
Average Usage (677 kWh)	$61.80	$69.35	$7.56	12.23%	19.76%
Median Usage (531 kWh)	$50.26	$56.19	$5.93	11.79%	19.28%

Q. Please describe the rate impact associated with the two surcharges proposed by APS in its February 2, 2006, filing.

A. The purpose of these surcharges is to recover the $59.9 million of 2005 fuel and purchased power costs that fell outside of the $0.004 bandwidth of the PSA and carried forward to the Paragraph 19(d) Balancing Account. As proposed by APS, the first surcharge of $0.000554 per kWh, designed to collect $15.3 million over 12 months, would become effective concurrent with the emergency interim rate increase that APS has requested to begin in April 2006, but would more likely begin in May 2006 if approved by the Commission.

As a result of the first surcharge, the average summer bill for a residential customer on E-12 (using 1,047 kWh) would increase by $0.58 or 0.45 percent. The cumulative percent increase (including the April 2005 rate case decision, the resetting of the PSA adjustor rate, and the emergency interim rate increase) would be 19.82 percent for summer bills and 20.41 percent for winter bills.

Table 6
Impact of APS-Proposed May 2006 PSA Surcharge on Residential Customer Bills

	E-12 Bill After 5/06 Emergency Interim Rate Increase	E-12 Bill After 5/06 PSA Surcharge	Dollar Increase	Percent Increase	Cumulative Percent Increase Over pre-April 05 Rates
Summer (July)					
Average Usage (1047 kWh)	$128.94	$129.52	$0.58	0.45%	19.82%
Median Usage (818 kWh)	$96.79	$97.24	$0.45	0.47%	20.59%
Winter (December)					
Average Usage (677 kWh)	$69.35	$69.73	$0.38	0.54%	20.41%
Median Usage (531 kWh)	$56.19	$56.48	$0.29	0.52%	19.90%

As proposed by APS, a second surcharge of $0.001611 per kWh, designed to collect $44.6 million over 12 months, would become effective upon completion of the Commission's inquiry into the unplanned 2005 outages at the Palo Verde Nuclear Generating Station. For this analysis, Staff assumes that the inquiry would be completed in July 2006.

As a result of the second surcharge, the average summer bill for a residential customer on E-12 (using 1,047 kWh) would increase by $1.69 or 1.30 percent. The cumulative percent increase (including the April 2005 rate case decision, the resetting of the PSA adjustor rate, the emergency interim rate increase, and the May 2006 PSA surcharge) would be 21.38 percent for summer bills and 22.29 percent for winter bills.

Table 7
Impact of Second APS-Proposed 2006 PSA Surcharge on Residential Customer Bills

	E-12 Bill After 5/06 PSA Surcharge	E-12 Bill After 2nd 2006 PSA Surcharge	Dollar Increase	Percent Increase	Cumulative Percent Increase Over pre-April 05 Rates
Summer (July)					
Average Usage (1047 kWh)	$129.52	$131.21	$1.69	1.30%	21.38%
Median Usage (818 kWh)	$97.24	$98.56	$1.32	1.36%	22.23%
Winter (December)					
Average Usage (677 kWh)	$69.73	$70.82	$1.09	1.56%	22.29%
Median Usage (531 kWh)	$56.48	$57.34	$0.86	1.51%	21.72%

Q. Please describe the potential rate impact associated with APS' proposal in its general rate case.

A. This analysis assumes that APS would receive all the revenue it requested and that the E-12 rate schedule is designed as APS proposed. For this analysis, Staff assumes that rates from the rate case would become effective in January 2007. At that time, the emergency interim rate increase would cease because it is included in the general rate case, but the PSA adjustor rate and the two PSA surcharges would remain in effect.

As a result of APS-proposed rates in the general rate case, the average winter bill for a residential customer on E-12 (using 677 kWh) would increase by $1.20 or 1.69 percent over rates that include the emergency interim rate increase. The cumulative percent increase (including the April 2005 rate case decision, the resetting of the PSA adjustor rate, the May 2006 PSA surcharge, and the second 2006 surcharge) would be 24.37 percent for winter bills and 29.48 percent for summer bills.

**Table 8
Impact of 2006 General Rate Case
on Residential Customer Bills**

	E-12 Bill After 2nd 2006 PSA Surcharge	E-12 Bill After 2006 General Rate Case	Dollar Increase	Percent Increase	Cumulative Percent Increase Over pre-April 05 Rates
Summer (July)					
Average Usage (1047 kWh)	$131.21	$139.96	$8.75	6.67%	29.48%
Median Usage (818 kWh)	$98.56	$103.69	$5.13	5.20%	28.59%
Winter (December)					
Average Usage (677 kWh)	$70.82	$72.02	$1.20	1.69%	24.37%
Median Usage (531 kWh)	$57.34	$58.28	$0.94	1.64%	23.71%

Q. Does this conclude Staff's testimony?

A. Yes, it does.

RESUME

BARBARA KEENE

Education

B.S.	Political Science, Arizona State University (1976)
M.P.A.	Public Administration, Arizona State University (1982)
A.A.	Economics, Glendale Community College (1993)

Additional Training

Management Development Program - State of Arizona, 1986-1987
UPLAN Training - LCG Consulting, 1989, 1990, 1991
various seminars, workshops, and conferences on ratemaking, energy efficiency, rate design, computer skills, labor market information, training trainers, and Census products

Employment History

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst Manager (May 2005-present). Supervise the energy portion of the Telecommunications and Energy Section. Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst V (October 2001-present), Senior Economist (July 1990-October 2001), Economist II (December 1989-July 1990), Economist I (August 1989-December 1989). Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Department of Economic Security, Research Administration, Economic Analysis Unit: Labor Market Information Supervisor (September 1985-August 1989), Research and Statistical Analyst (September 1984-September 1985), Administrative Assistant (September 1983-September 1984). Supervised professional staff engaged in economic research and analysis. Responsible for occupational employment forecasts, wage surveys, economic development studies, and over 50 publications. Edited the monthly **Arizona Labor Market Information Newsletter**, which was distributed to about 4,000 companies and individuals.

Testimony

Resource Planning for Electric Utilities (Docket No. U-0000-90-088), Arizona Corporation Commission, 1990; testimony on production costs and system reliability.

Trico Electric Cooperative Rate Case (Docket No. U-1461-91-254), Arizona Corporation Commission, 1992; testimony on demand-side management and time-of-use and interruptible power rates.

Navopache Electric Cooperative Rate Case (Docket No. U-1787-91-280), Arizona Corporation Commission, 1992; testimony on demand-side management and economic development rates.

Arizona Electric Power Cooperative Rate Case (Docket No. U-1773-92-214), Arizona Corporation Commission, 1993; testimony on demand-side management, interruptible power, and rate design.

Tucson Electric Power Company Rate Case (Docket Nos. U-1933-93-006 and U-1933-93-066) Arizona Corporation Commission, 1993; testimony on demand-side management and a cogeneration agreement.

Resource Planning for Electric Utilities (Docket No. U-0000-93-052), Arizona Corporation Commission, 1993; testimony on production costs, system reliability, and demand-side management.

Duncan Valley Electric Cooperative Rate Case (Docket No. E-01703A-98-0431), Arizona Corporation Commission, 1999; testimony on demand-side management and renewable energy.

Tucson Electric Power Company vs. Cyprus Sierrita Corporation, Inc. (Docket No. E-0000I-99-0243), Arizona Corporation Commission, 1999; testimony on analysis of special contracts.

Arizona Public Service Company's Request for Variance (Docket No. E-01345A-01-0822), Arizona Corporation Commission, 2002; testimony on competitive bidding.

Generic Proceeding Concerning Electric Restructuring Issues (Docket No. E-00000A-02-0051), Arizona Corporation Commission, 2002; testimony on affiliate relationships and codes of conduct.

Tucson Electric Power Company's Application for Approval of New Partial Requirements Service Tariffs, Modification of Existing Partial Requirements Service Tariff 101, and Elimination of Qualifying Facility Tariffs (Docket No. E-01933A-02-0345) and Application for Approval of its Stranded Cost Recovery (Docket No. E-01933A-98-0471), Arizona Corporation Commission, 2002, testimony on proposals to eliminate, modify, or introduce tariffs and testimony on the modification of the Market Generation Credit.

Arizona Public Service Company's Application for Approval of Adjustment Mechanisms (Docket No. E-01345A-02-0403), Arizona Corporation Commission, 2003, testimony on the proposed Power Supply Adjustment and the proposed Competition Rules Compliance Charge.

Generic Proceeding Concerning Electric Restructuring Issues, et al (Docket No. E-00000A-02-0051, et al), Arizona Corporation Commission, 2003-2005; Staff Report and testimony on Code of Conduct.

Arizona Public Service Company Rate Case (Docket No. E-01345A-03-0437), Arizona Corporation Commission, 2004; testimony on demand-side management, system benefits, renewable energy, the Returning Customer Direct Assignment Charge, and service schedules.

Arizona Electric Power Cooperative Rate Case (Docket No. E-01773A-04-0528), Arizona Corporation Commission, 2005; testimony on a fuel and purchased power cost adjustor, demand-side management, and rate design.

Trico Electric Cooperative Rate Case (Docket No. E-01461A-04-0607), Arizona Corporation Commission, 2005; testimony on the Environmental Portfolio Standard; demand-side management; special charges; and Rules, Regulations, and Line Extension Policies.

Arizona Public Service Company (Docket Nos. E-01345A-03-0437 and E-01345A-05-0526), Arizona Corporation Commission, 2005; testimony on the Plan of Administration of the Power Supply Adjustor.

Publications

Author of the following articles published in the *Arizona Labor Market Information Newsletter*:

"1982 Mining Employees - Where are They Now?" - September 1984
"The Cost of Hiring" and "Arizona's Growing Industries" - January 1985
"Union Membership - Declining or Shifting?" - December 1985
"Growing Industries in Arizona" - April 1986
"Women's Work?" - July 1986
"1987 SIC Revision" - December 1986
"Growing and Declining Industries" - June 1987
"1986 DOT Supplement" and "Consumer Expenditure Survey" - July 1987
"The Consumer Price Index: Changing With the Times" - August 1987
"Average Annual Pay" - November 1987
"Annual Pay in Metropolitan Areas" - January 1988
"The Growing Temporary Help Industry" - February 1988
"Update on the Consumer Expenditure Survey" - April 1988
"Employee Leasing" - August 1988
"Metropolitan Counties Benefit from State's Growing Industries" - November 1988
"Arizona Network Gives Small Firms Helping Hand" - June 1989

Major contributor to the following books published by the Arizona Department of Economic Security:

Annual Planning Information - editions from 1984 to 1989
Hispanics in Transition - 1987

(with David Berry) "Contracting for Power," *Business Economics*, October 1995.

(with Robert Gray) "Customer Selection Issues," *NRRI Quarterly Bulletin*, Spring 1998.

Reports

(with Task Force) *Report of the Task Force on the Feasibility of Implementing Sliding Scale Hookup Fees*. Arizona Corporation Commission, 1992.

Customer Repayment of Utility DSM Costs, Arizona Corporation Commission, 1995.

(with Working Group) *Report of the Participants in Workshops on Customer Selection Issues*," Arizona Corporation Commission, 1997.

"DSM Workshop Progress Report," Arizona Corporation Commission, 2004.

(with Erin Casper) "Staff Report on Demand Side Management Policy," Arizona Corporation Commission, 2005.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 1
Annual Tracking Account
Projected Year 2006 (no emergency increase)

Line No.	Month	(a) Retail[1] Energy Sales (kWh)	(b) Wholesale[2] Native Load Energy Sales (kWh)	(c) Total Native Load Energy Sales (kWh)	(d) System [3] Book Fuel and Purchased Power Costs	(e) System Book [4] Off-System Sales Revenue	(f) Net Native Load Power Supply Costs	(g) Retail[5] Power Supply Costs	(h) Base Rate[7] Power Supply Revenue	(i) Pre-90/10 Sharing (Over)/Under Collection	(j) Post-90/10 Sharing (Over)/Under Collection	(k) Interest	(l) Tracking Account Balance
				(a + b)			(d - e)	(a/c * f)	(a * base cost)	(g - h)	(i * 0.9)	(l*rate/12)	(j+k+l)
1	Jan.	[redacted]					[redacted]						
2	Feb.												
3	Mar.												
4	Apr.												
5	May												
6	Jun.												
7	Jul.												
8	Aug.												
9	Sep.												
10	Oct.												
11	Nov.												
12	Dec.												
13	Total	[redacted]					[redacted]						
14	interest rate[6] =		4.38%										

[1] Retail energy sales under rate schedule E-36 were excluded.
[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.
[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Excludes net savings associated with the Sundance units and broker fees.
[4] Includes off-system revenue less mark-to-market accounting adjustments.
[5] The maximum annual amount that can be used for the PSA calculation is $776,200,000. However, Decision No. 68437 allows deferral of costs in excess of the cap until this issue has been further examined in Docket No. E-01345A-06-0009.
[6] Based on one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15.
[7] The base cost was $0.020743 per kWh.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 1
Annual Tracking Account
Projected Year 2006 (with emergency increase)

Line No.	Month	(a) Retail[1] Energy Sales (kWh)	(b) Wholesale[2] Native Load Energy Sales (kWh)	(c) Total Native Load Energy Sales (kWh)	(d) System[3] Book Fuel and Purchased Power Costs	(e) System Book[4] Off-System Sales Revenue	(f) Net Native Load Power Supply Costs	(g) Retail[5] Power Supply Costs	(h) Base Rate[7] Power Supply Revenue	(i) Pre-90/10 Sharing (Over)/Under Collection	(j) Post-90/10 Sharing (Over)/Under Collection	(k) Interest	(l) Tracking Account Balance
				(a + b)			(d - e)	(a/c * f)	(a * base cost)	(g - h)	(i * 0.9)	(l*rate/12)	(j+k+l)
1	Jan.	[redacted]					[redacted]						
2	Feb.												
3	Mar.												
4	Apr.												
5	May												
6	Jun.												
7	Jul.												
8	Aug.												
9	Sep.												
10	Oct.												
11	Nov.												
12	Dec.												
13	Total	[redacted]					[redacted]						
14		interest rate[6] =	4.38%										

[1] Retail energy sales under rate schedule E-36 were excluded.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native *load and off-system fuel and purchased power costs* less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Excludes net savings associated with the Sundance units and broker fees.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

[5] The maximum annual amount that can be used for the PSA calculation is $776,200,000. However, Decision No. 68437 allows deferral of costs in excess of the cap until this issue has been further examined in Docket No. E-01345A-06-0009.

[6] Based on one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15.

[7] **The base cost was $0.020743 per kWh from January through April and $0.031904 per kWh from May through December..**

ARIZONA PUBLIC SERVICE COMPANY
Schedule 2
2007 PSA Adjustor Rate Calculation (with emergency increase, no surcharges)

Line No.	PSA Adjustor Rate Calculation			
1	Tracking Account Balance (from Schedule 1)		[redacted]	
2	Annual Adjustor Account Balance (from Schedule 3)		[redacted]	
3	Paragraph 19(d) Balancing Account Balance (from Schedule 4)		[redacted]	
4	Total (Credit)/Charge Amount (Line 1 + Line 2 + Line 3)			[redacted]
5	Projected Energy Sales without E-3, E-4 and E-36 (kWh)	[redacted]		
6	Computed Adjustor Rate per kWh (Line 4/ Line 5)		[redacted]	
7	Current Adjustor Rate per kWh	$0.004000		
8	Diff. between Current Adj. Rate and Computed Adj. Rate (line 6 - line 7)	[redacted]		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for February 1, 2007			[redacted]
12	Amount Carried Forward to Annual Adjustor Account (Line 5 * Line 11)			[redacted]
13	Amount Carried Forward to Paragraph 19(d) Balancing Account (Line 4 - Line 12)			[redacted]

ARIZONA PUBLIC SERVICE COMPANY
Schedule 2
2007 PSA Adjustor Rate Calculation (no emergency increase, no surcharges)

Line No.	PSA Adjustor Rate Calculation			
1	Tracking Account Balance (from Schedule 1)		[redacted]	
2	Annual Adjustor Account Balance (from Schedule 3)		[redacted]	
3	Paragraph 19(d) Balancing Account Balance (from Schedule 4)		[redacted]	
4	Total (Credit)/Charge Amount (Line 1 + Line 2 + Line 3)			[redacted]
5	Projected Energy Sales without E-3, E-4 and E-36 (kWh)	[redacted]		
6	Computed Adjustor Rate per kWh (Line 4/ Line 5)		[redacted]	
7	Current Adjustor Rate per kWh	$0.004000		
8	Diff. between Current Adj. Rate and Computed Adj. Rate (line 6 - line 7)	[redacted]		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for February 1, 2007			[redacted]
12	Amount Carried Forward to Annual Adjustor Account (Line 5 * Line 11)			[redacted]
13	Amount Carried Forward to Paragraph 19(d) Balancing Account (Line 4 - Line 12)			[redacted]

ARIZONA PUBLIC SERVICE COMPANY
Schedule 3
Annual Adjustor Account
Projected Year February 2006 - January 2007

Line No.		February	March	April	May	June	July	August	September	October	November	December	January
1	PSA Adjustor Rate	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000	$ 0.004000
2	Beginning Balance	$ 109,723,888	[redacted]										
3	Retail Energy Sales[1] (kWh)	[redacted]											
4	Less: Revenue from Adjustor Rate (line 1 * line 3)												
5	Balance before Interest (line 2 - line 4)												
6	Monthly Interest (line 5 * (4.38%/12)[2]												
7	Ending Balance with Interest (line 5 + line 6)												

[1] Excludes sales from E-36, E-3, and E-4 rate schedules.
[2] Based on one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 4
Paragraph 19(d) Balancing Account
Projected Year February 2006 - January 2007

Line No.		February	March	April	May	June	July	August	September	October	November	December	January
1	Beginning Balance	[redacted]											
2	Less: Approved Balance for Surcharge (if any)												
3	Balance Less Amort. Surcharge (line 1 - line 2)												
4	Monthly Interest (line 3 * (4.38%/12)[1]												
5	Ending Balance with Interest (line 3 + line 4)												

[1] Based on one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15.

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN EMERGENCY INTERIM RATE INCREASE AND FOR AN INTERIM AMENDMENT TO DECISION NO. 67744	DOCKET NO. E-01345A-06-0009

DIRECT

TESTIMONY

OF

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ARIZONA CORPORATION COMMISSION

FEBRUARY 28, 2006

TABLE OF CONTENTS

Page

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-06-0009

On January 6, 2006, Arizona Public Service ("APS" or "Company") filed with the Commission an application for an emergency interim rate increase and for an interim amendment to Decision No. 67744. The interim rate increase of $299 million in additional annual revenues, or approximately a 14 percent increase, was requested to have an April 1, 2006 implementation date.

The result of Staff's analysis indicates that the APS production cost simulation model provides a reasonable assessment of projected uncollected fuel and purchased power expenses through 2006. The volatility of projections is minimized because APS has hedged 85 percent of its natural gas and purchased power costs for 2006. Barring a significant change in the actual load, or a loss of a base generating unit, the projected uncollected fuel and purchase power expenses are predictable.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is William Gehlen. I am a Public Utilities Analyst V employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utility Analyst V.

A. In my capacity as a Public Utilities Analyst V, I provide recommendations to the Commission on energy-related issues.

Q. Please describe your educational background and professional experience.

A. I earned a BS degree in Business Administration from Aquinas College, and an MBA from Western Michigan University. My background includes 26 years of utility experience with 16 years in investor-owned utilities. In the fuels area, I have been responsible for the planning, procurement and transportation of multiple fuel categories (natural gas, gasoline, coal, oil and nuclear). In addition, I have been responsible for the procurement of land, equipment, services, consulting and construction contracts, and purchased power (short-, medium- and long-term). Management positions also included responsibility for integrated resource planning, long-range forecasting, transmission planning, environmental affairs and strategic planning. My most recent 10 years experience includes one year with Office of Consumer Advocate for the State of Nevada as a regulatory analyst, and nine years in the development and marketing of energy trading platforms, origination of purchased power agreements, real time energy trading, and support of merchant generators in gathering market intelligence on regulatory, fuel and product issues to aid in understanding inter and intra regional market design issues and solutions.

Q. What is the scope of your testimony in this case?

A. I will address the Arizona Public Service Company ("APS" or "Company") request for an emergency interim rate increase of $299 million in annual revenue, and for an interim amendment to Decision No. 67744. I will evaluate the APS load forecast and hedging assumptions to determine the reasonableness of the projected uncollected fuel and purchased power expenses.

KEY COMPONENTS AND PROJECTIONS

Q. Describe the key components in the calculation of projected uncollected fuel and purchased power expenses.

A. The key planning component in determining fuel and purchased power costs is the load forecast. Modeling assumptions in the APS production cost simulation model are keyed to the load forecast. The projected usage of fuel and purchased power are calculated in the modeling process as their demand is determined by dispatching APS generating units on an economic basis.

Q. Describe the Company's production cost simulation model.

A. The APS production cost simulation model simulates the dispatch of generation units on an hourly and daily basis. The variables included in the simulation are load shape, fuel prices (including wholesale market prices for power) and characteristics of APS-owned generating plants (heat rates, overhaul cycles, unplanned outage rates, start-up costs and ramp rates), along with commitments for purchases and sales of power. In addition, the model simulates market purchases when load exceeds generating capacity, and conversely simulates market sales when the generating units are not fully utilized. As the production cost simulation model dispatches units in merit order sequence, the fuel cost associated with each unit is utilized. The average costs of coal and nuclear power are fairly predictable while the costs of gas and purchased power have been hedged to lock in a known cost for 85 percent of APS' predicted requirement.

Q. Describe the Company's fuel and purchased power hedges for 2006.

A. The Company has developed a hedge implementation strategy. The intent of the strategy is to manage price risk that has arisen from increased volatility in the natural gas and purchased power markets. At present, the Company has hedged 85 percent of its 2006 natural gas and purchased power requirements. The 2006 hedges were entered into over a two year period (25 percent hedged by November 8, 2004; 50 percent hedged by April 13, 2005; and 85 percent hedged by August 29, 2005). As such, the prices associated with 85 percent of the natural gas and purchased power for 2006 are known. Assuming an accurate load forecast, the 15 percent that is not hedged will be obtained at market prices which may be higher, or lower, than the hedged amounts.

Q. **If fuel and purchased power costs are lower in 2006, will there be a significant impact on the projected uncollected fuel and purchased power expenses?**

A. No. With 85 percent of the 2006 natural gas and purchased power costs known values, the projected uncollected fuel and purchased power cost changes, both up or down, are limited. Uncollected fuel and purchased power expenses are as much influenced by actual load as fuel and purchased power prices. The actual load incurred versus forecasted load will determine the actual need for fuel and purchased power. Natural gas and purchased power prices have recently been dropping but the impact, if any, of these recent prices is hard to determine. The projected load forecast may be low, and gas and purchased power prices may increase with increased demand during the peak usage months of June through September, or not. Both the load forecast and fuel and purchased power prices can, and will, vary but neither variable will result in a significant impact on uncollected fuel and purchased power expenses as long as the other forecast variables are held constant.

Q. What would have the greatest impact on projected uncollected fuel and purchased power expenses?

A. With hedging of natural gas and purchased power, the greatest impact on fuel and purchased power expenses would be the loss of a nuclear, or coal, base unit resource during the peak June through September period. To cover the loss of a base generating unit, APS would become even more reliant on its gas generating units as well as the purchased power market which is indexed to the price of natural gas. This would result in a dramatic increase in gas and purchased power costs. An example of this is the $44.6 million APS spent to cover power replacement cost for Palo Verde associated outages in 2005 (Docket No. E-01345A-06-0063).

CONCLUSION

Q. Are the APS projections for uncollected fuel and purchased power expenses reasonable?

A. Yes. Staff evaluated the assumptions utilized in calculating the various projections for uncollected fuel and purchased power expenses for 2006. The software utilized and assumptions on load growth, outage rates, fuel costs and characteristics of APS generating plants are consistent with projections developed for Docket No. E-01345A-05-0526 (Application of APS for Approval of a Power Supply Adjustor Surcharge). The projected uncollected balances proved reliable utilizing a hedging percentage of 75 percent. The 85 percent hedging of fuel and purchased costs for 2006 in this docket remove even more volatility from projections, which should provide more reliable projections than those for 2005.

Q. Does this conclude your direct testimony?

A. Yes, it does.